QUANTUM CORP /DE/
Form 10-Q
February 09, 2012

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-Q

x	**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
	For the quarterly period ended December 31, 2011

OR

o	**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
	For the transition period from _______ to _______

Commission File Number 1-13449

QUANTUM CORPORATION

Incorporated Pursuant to the Laws of the State of Delaware

IRS Employer Identification Number 94-2665054

1650 Technology Drive, Suite 800, San Jose, California 95110

(408) 944-4000

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934, during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No o

Indicate by checkmark whether the registrant has submitted electronically and posted on its corporate website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No o

Indicate by checkmark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definition of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer o Accelerated filer x Non-accelerated filer o Smaller reporting company o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No x

As of the close of business on February 3, 2012, approximately 234.3 million shares of Quantum Corporation s common stock were issued and outstanding.

QUANTUM CORPORATION

INDEX

PART I FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

QUANTUM CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands, except per share data)
(Unaudited)

	Three Months Ended		Nine Months Ended	
	December 31, 2011	December 31, 2010	December 31, 2011	December 31, 2010
Product revenue	$ 124,081	$ 123,218	$ 341,475	$ 344,001
Service revenue	35,362	37,365	107,956	113,730
Royalty revenue	14,049	15,643	42,635	49,442
Total revenue	173,492	176,226	492,066	507,173
Cost of product revenue	77,238	77,456	218,044	221,158
Cost of service revenue	22,537	23,200	65,732	71,595
Restructuring benefit related to cost of revenue			(300)	
Total cost of revenue	99,775	100,656	283,476	292,753
Gross margin	73,717	75,570	208,590	214,420
Operating expenses:				
Research and development	17,629	18,240	55,212	54,490
Sales and marketing	33,350	31,776	94,990	90,973
General and administrative	15,759	14,176	46,991	44,600
Restructuring charges			699	11
Total operating expenses	66,738	64,192	197,892	190,074
Gain on sale of patents			1,500	
Income from operations	6,979	11,378	12,198	24,346
Interest income and other, net	(142)	(250)	(422)	24
Interest expense	(2,450)	(4,761)	(8,111)	(16,877)
Loss on debt extinguishment		(1,186)		(1,186)
Income before income taxes	4,387	5,181	3,665	6,307
Income tax provision (benefit)	473	(683)	1,416	114
Net income	$ 3,914	$ 5,864	$ 2,249	$ 6,193
Basic and diluted net income per share:	$ 0.02	$ 0.03	$ 0.01	$ 0.03
Weighted average common and common equivalent shares:				
Basic	233,812	222,801	231,661	219,052
Diluted	239,912	235,099	239,261	228,154

See accompanying Notes to Condensed Consolidated Financial Statements.

QUANTUM CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands, except par value)
(Unaudited)

	December 31, 2011	March 31, 2011
Assets		
Current assets:		
Cash and cash equivalents	$ 59,250	$ 76,010
Restricted cash	3,987	1,863
Accounts receivable, net of allowance for doubtful accounts of $206 and $403, respectively	115,106	114,969
Manufacturing inventories	58,879	48,131
Service parts inventories	41,036	45,036
Deferred income taxes	6,384	6,271
Other current assets	10,358	11,274
Total current assets	295,000	303,554
Long-term assets:		
Property and equipment, less accumulated depreciation	24,818	24,980
Amortizable intangible assets, less accumulated amortization	30,454	44,711
In-process research and development	349	
Goodwill	55,613	46,770
Other long-term assets	8,962	10,950
Total long-term assets	120,196	127,411
	$ 415,196	$ 430,965
Liabilities and Stockholders Deficit		
Current liabilities:		
Accounts payable	$ 59,238	$ 52,203
Accrued warranty	7,080	7,034
Deferred revenue, current	84,537	87,488
Current portion of long-term debt	708	1,067
Accrued restructuring charges	689	4,028
Accrued compensation	33,072	31,249
Income taxes payable	1,542	1,172
Other accrued liabilities	19,277	21,418
Total current liabilities	206,143	205,659
Long-term liabilities:		
Deferred revenue, long-term	34,533	34,281
Deferred income taxes	6,129	6,820
Long-term debt	67,929	103,267
Convertible subordinated debt	135,000	135,000
Other long-term liabilities	7,199	7,049
Total long-term liabilities	250,790	286,417
Stockholders deficit:		
Common stock, $0.01 par value; 1,000,000 shares authorized; 234,127 and 227,311 shares issued and outstanding at December 31, 2011 and March 31, 2011, respectively	2,341	2,273
Capital in excess of par	403,724	385,911
Accumulated deficit	(454,339)	(456,588)
Accumulated other comprehensive income	6,537	7,293
Total stockholders deficit	(41,737)	(61,111)
	$ 415,196	$ 430,965

See accompanying Notes to Condensed Consolidated Financial Statements.

2

QUANTUM CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)
(In thousands)

	Nine Months Ended December 31, 2011	December 31, 2010
Cash flows from operating activities:		
Net income	$ 2,249	$ 6,193
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	8,776	8,780
Amortization	17,785	23,728
Service parts lower of cost or market adjustment	7,564	10,957
Loss on debt extinguishment		1,186
Deferred income taxes	(785)	(417)
Share-based compensation	10,246	8,050
Changes in assets and liabilities, net of effect of acquisition:		
Accounts receivable	(131)	(15,350)
Manufacturing inventories	(17,463)	(5,861)
Service parts inventories	3,150	1,524
Accounts payable	7,052	2,000
Accrued warranty	46	626
Deferred revenue	(2,727)	(9,312)
Accrued restructuring charges	(3,347)	(2,856)
Accrued compensation	1,975	(1,068)
Income taxes payable	438	(1,159)
Other assets and liabilities	(1,735)	1,900
Net cash provided by operating activities	33,093	28,921
Cash flows from investing activities:		
Purchases of property and equipment	(8,538)	(9,348)
(Increase) decrease in restricted cash	(2,317)	222
Return of principal from other investments	97	95
Payment for business acquisition, net of cash acquired	(8,152)	
Net cash used in investing activities	(18,910)	(9,031)
Cash flows from financing activities:		
Repayments of long-term debt	(35,698)	(163,079)
Borrowings of convertible subordinated debt, net		130,022
Repayments of convertible subordinated debt		(22,099)
Payment of taxes due upon vesting of restricted stock	(2,638)	(2,165)
Proceeds from issuance of common stock	7,506	13,635
Net cash used in financing activities	(30,830)	(43,686)
Effect of exchange rate changes on cash and cash equivalents	(113)	47
Net decrease in cash and cash equivalents	(16,760)	(23,749)
Cash and cash equivalents at beginning of period	76,010	114,947
Cash and cash equivalents at end of period	$ 59,250	$ 91,198
Fair value of common stock issued for business combination	$ 2,767	$

See accompanying Notes to Condensed Consolidated Financial Statements.

QUANTUM CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

NOTE 1: BASIS OF PRESENTATION

Quantum Corporation (Quantum , the Company , us or we) (NYSE: QTM), founded in 1980, is a global expert in data protection and big data management. Combining focused expertise, customer-driven innovation and platform independence, we provide a comprehensive, integrated range of disk, tape and software solutions to solve data protection and big data management challenges supported by our sales and service organization. We work closely with a broad network of distributors, value-added resellers (VARs), direct marketing resellers, original equipment manufacturers (OEMs) and other suppliers to meet customers evolving data protection and big data management needs.

The accompanying unaudited Condensed Consolidated Financial Statements include the accounts of Quantum and its wholly-owned subsidiaries. On June 13, 2011, we acquired Pancetera Software, Inc. (Pancetera), and Pancetera s results of operations are included in our Condensed Consolidated Statement of Operations from that date. All intercompany balances and transactions have been eliminated. The interim financial statements reflect all adjustments, consisting of normal recurring adjustments that, in the opinion of management, are necessary for a fair statement of the results for the periods shown. The results of operations for such periods are not necessarily indicative of the results expected for the full fiscal year. The Consolidated Balance Sheet as of March 31, 2011 has been derived from the audited financial statements at that date. However, it does not include all of the information and notes required by accounting principles generally accepted in the United States for complete financial statements. The accompanying financial statements should be read in conjunction with the audited Consolidated Financial Statements for the fiscal year ended March 31, 2011 included in our Annual Report on Form 10-K, as filed with the Securities and Exchange Commission on June 14, 2011.

NOTE 2: SIGNIFICANT ACCOUNTING POLICIES; NEW ACCOUNTING STANDARDS

Significant Accounting Policies

Except for the business combination policy noted below, the significant accounting policies used in the preparation of our Condensed Consolidated Financial Statements are unchanged and are disclosed in our Annual Report on Form 10-K for the year ended March 31, 2011, as filed with the Securities and Exchange Commission on June 14, 2011.

We allocate the purchase price paid to the assets acquired and liabilities assumed in a business combination at their estimated fair values as of the acquisition date. Any excess purchase price above the identified net tangible and intangible assets and assumed liabilities is allocated to goodwill. We consider fair value to be the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The fair value hierarchy is used to assess the fair value of assets acquired and liabilities assumed. We evaluate the tangible and intangible assets as well as liabilities and contingencies of the acquired company.

New Accounting Standards Adopted

In the first quarter of fiscal 2012, we adopted the goodwill impairment guidance for reporting units with zero or negative carrying amounts. Adoption of this standard did not have an impact on our financial position or results of operations.

In the first quarter of fiscal 2012, we adopted the guidance for disclosure of supplementary pro forma information for business combinations. Adoption of this standard did not have an impact on our financial position or results of operations, other than the additional disclosures included in the notes to the Condensed Consolidated Financial Statements.

Recent Accounting Pronouncements

In May 2011, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update No. 2011-04, *Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs* (ASU 2011-04), which amends the accounting standards for fair value measurements and disclosures. ASU 2011-04 provides clarifications about the application of existing fair value measurement and disclosure requirements. In addition, ASU 2011-04 changes how to measure fair value of financial instruments managed within a portfolio and how to apply premiums and discounts. There are also additional disclosures required. ASU 2011-04 is effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. We will apply this standard beginning in fiscal 2013 and do not anticipate adoption will impact our statements of financial position or results of operations.

In June 2011, the FASB issued Accounting Standards Update No. 2011-05, *Comprehensive Income (Topic 220): Presentation of Comprehensive Income* (ASU 2011-05) and in December 2011, the FASB issued Accounting Standards Update No. 2011-12, *Comprehensive Income (Topic 220): Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05* (ASU 2011-12). ASU 2011-05 requires that components of other comprehensive income be presented in a single continuous statement of comprehensive income or in two separate but consecutive statements of net income and its components followed immediately by a statement of total other comprehensive income. ASU 2011-12 defers the reclassification adjustments that were initially required in ASU 2011-05. Both ASU 2011-05 and ASU 2011-12 are effective for fiscal years, and interim periods within those years, beginning after December 15, 2011, or our fiscal 2013. We are considering early adoption of ASU 2011-05 and ASU 2011-12. Adoption of these ASUs will affect presentation only and will not impact our statements of financial position or results of operations.

In September 2011, the FASB issued Accounting Standards Update No. 2011-08, *Intangibles Goodwill and Other (Topic 350) Testing Goodwill for Impairment* (ASU 2011-08). ASU 2011-08 provides entities the option to perform a qualitative assessment for step one impairment testing. ASU 2011-08 is effective for fiscal years beginning after December 15, 2011; however, early adoption is permitted if the current fiscal year test has not been performed. We plan to early adopt ASU 2011-08 in the fourth quarter of fiscal 2012 and do not anticipate adoption will impact our statements of financial position or results of operations.

NOTE 3: ACQUISITION

On June 13, 2011, in order to enhance our product offerings and technology portfolio we acquired Pancetera pursuant to a statutory merger in exchange for approximately $11.0 million, comprised of $8.2 million in cash and $2.8 million in Quantum common stock. We acquired all outstanding shares of Pancetera and assumed all of Pancetera s outstanding unvested stock options according to the option exchange ratio defined in the merger agreement with Pancetera. We also assumed unvested restricted Pancetera common stock in accordance with the merger agreement. Pancetera s results of operations are included in our Condensed Consolidated Statements of Operations and Cash Flows from the June 13, 2011 acquisition date.

The acquisition was recorded under the acquisition method of accounting, resulting in the purchase price being allocated to the assets acquired and liabilities assumed based on their estimated fair values. The excess of the purchase price over the assets acquired and liabilities assumed was recorded as goodwill. The preliminary allocation of assets acquired and liabilities assumed is set forth below (in thousands):

Current assets	$	46
Property and equipment		37
Amortizable intangible assets		1,795
In-process research and development		349
Goodwill		8,843
Current liabilities		(116)
Total purchase price	$	10,954

In performing our purchase price allocation, we considered, among other factors, our intention for future use of acquired assets, analyses of historical financial performance and estimates of future performance of Pancetera s existing and future products. The fair value of current assets, property and equipment and current liabilities was based on market prices at the acquisition date. The fair value of amortizable intangible assets and in-process research and development (IPR&D) was based, in part, on a valuation using a discounted cash flow approach and other valuation techniques as well as management s estimates and assumptions.

The amortizable intangible assets are all related to developed technology and are included in purchased technology within Note 6: Intangible Assets and Goodwill. Purchased technology, which comprises products that have reached technological feasibility, was primarily related to SmartRead®. SmartRead is patented technology, primarily comprised of a set of algorithms that reduce storage input-output when performing maintenance tasks such as backup, replication or migration of virtual machines. Pancetera products containing the SmartRead technology included SmartView™ and SmartMotion™, which have been rebranded as vmPRO software solutions. Purchased technology intangible assets also include a combination of Pancetera processes, patents and trade secrets related to the design and development of these products. This proprietary know-how can be leveraged to develop new technology and improve our products. The SmartRead purchased technology intangible asset has an amortization period of four years.

IPR&D represents incomplete Pancetera research and development projects that had not reached technological feasibility as of the acquisition date. Due to the nature of IPR&D, the expected life is indeterminate and we periodically evaluate for attainment of technological feasibility or impairment. Technological feasibility is established when an enterprise has completed all planning, designing, coding and testing activities that are necessary to establish that a product can be produced to meet its design specifications including functions, features and technical performance requirements. The value assigned to IPR&D was determined by considering the importance of each project to our overall development plan, estimating costs to develop the purchased IPR&D into commercially viable products, estimating the resulting net cash flows from the projects when completed and discounting the net cash flows using a discount rate of 18% to their present value based on the percentage of completion of the IPR&D projects.

The goodwill as a result of this acquisition is not expected to be deductible for tax purposes. The results of operations for the third quarter and first nine months of fiscal 2012 included immaterial revenue and a $0.6 million and $1.7 million net loss, respectively, of Pancetera since the acquisition date. In addition, we incurred acquisition expenses of $0.3 million during the first nine months of fiscal 2012 which are included in general and administrative expense in our Condensed Consolidated Statements of Operations.

The following unaudited supplemental pro forma information presents the combined results of operations of Quantum and Pancetera as if the acquisition had occurred as of the beginning of fiscal 2011. The first nine months of fiscal 2011 supplemental pro forma earnings were adjusted to include $1.0 million in nonrecurring acquisition expenses incurred in the first nine months of fiscal 2012. This amount has been excluded from the first nine months of fiscal 2012 supplemental pro forma earnings (in thousands):

	Three Months Ended	Nine Months Ended	
	December 31, 2010	December 31, 2011	December 31, 2010
Pro forma revenue	$ 176,305	$ 492,099	$ 507,269
Pro forma net income	$ 4,653	$ 1,575	$ 1,724

NOTE 4: FAIR VALUE

The assets acquired and liabilities assumed from Pancetera were recorded at their respective fair values on the acquisition date. The following fair value disclosures are in regard to the remainder of our assets and liabilities.

The assets measured and recorded at fair value on a recurring basis consist of money market funds which are valued using quoted market prices at the respective balance sheet dates and are level 1 fair value measurements (in thousands):

	December 31, 2011	March 31, 2011
Money market funds	$ 47,336	$ 68,560

We have certain non-financial assets that are measured at fair value on a non-recurring basis when there is an indicator of impairment, and they are recorded at fair value only when an impairment is recognized. These assets include property and equipment, amortizable intangible assets, IPR&D and goodwill. We did not record impairments to any non-financial assets in the third quarter or first nine months of fiscal 2012 or 2011. We do not have any non-financial liabilities measured and recorded at fair value on a non-recurring basis.

We have financial liabilities for which we are obligated to repay the carrying value. The carrying value and fair value of these financial liabilities at December 31, 2011 and March 31, 2011 were as follows (in thousands):

	December 31, 2011		March 31, 2011	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Credit Suisse term loan[(1)]	$ 68,637	$ 67,264	$ 104,334	$ 103,812
Convertible subordinated notes[(2)]	135,000	132,300	135,000	133,126

(1) Fair value based on non-binding broker quotes using current market information.

(2) Fair value based on quoted market prices.

NOTE 5: INVENTORIES

Manufacturing inventories and service parts inventories consisted of the following (in thousands):

	December 31, 2011	March 31, 2011
Manufacturing inventories:		
Finished goods	$ 20,506	$ 19,999
Work in process	6,114	7,385
Materials and purchased parts	32,259	20,747
	$ 58,879	$ 48,131
Service parts inventories:		
Finished goods	$ 21,440	$ 25,348
Component parts	19,596	19,688
	$ 41,036	$ 45,036

NOTE 6: INTANGIBLE ASSETS AND GOODWILL

Intangible assets are evaluated for impairment whenever indicators of impairment are present. During the third quarter of fiscal 2012 and 2011, we considered whether there were any indicators of impairment for both our goodwill and our long-lived assets, including amortizable and indefinite-lived intangible assets, and determined there were none.

The following provides a summary of the carrying value of amortizable intangible assets (in thousands):

	As of December 31, 2011			As of March 31, 2011		
	Gross Amount	Accumulated Amortization	Net Amount	Gross Amount	Accumulated Amortization	Net Amount
Purchased technology	$ 189,962	$ (182,499)	$ 7,463	$ 188,167	$ (176,350)	$ 11,817
Trademarks	27,260	(26,854)	406	27,260	(26,316)	944
Non-compete agreements	500	(500)		500	(468)	32
Customer lists	106,419	(83,834)	22,585	106,419	(74,501)	31,918
	$ 324,141	$ (293,687)	$ 30,454	$ 322,346	$ (277,635)	$ 44,711

Total intangible amortization expense was $4.7 million and $16.1 million for the three and nine months ended December 31, 2011, respectively, and was $5.9 million and $22.5 million for the three and nine months ended December 31, 2010, respectively.

We evaluate goodwill for impairment annually during the fourth quarter of our fiscal year, or more frequently when indicators of impairment are present. The following provides a summary of the carrying value of goodwill (in thousands):

	Goodwill	Accumulated Impairment Losses	Total
Beginning Balance March 31, 2011	$ 385,770	$ (339,000)	$ 46,770
Pancetera Acquisition	8,843		8,843
Ending Balance December 31, 2011	$ 394,613	$ (339,000)	$ 55,613

NOTE 7: ACCRUED WARRANTY

The quarterly and year-to-date changes in the accrued warranty balance were (in thousands):

	Three Months Ended		Nine Months Ended	
	December 31, 2011	December 31, 2010	December 31, 2011	December 31, 2010
Beginning balance	$ 7,113	$ 6,214	$ 7,034	$ 5,884
Additional warranties issued	2,427	3,059	7,123	8,264
Adjustments for warranties issued in prior fiscal years	483	614	1,247	1,740
Settlements	(2,943)	(3,376)	(8,324)	(9,377)
Ending balance	$ 7,080	$ 6,511	$ 7,080	$ 6,511

We generally warrant our products against defects from 12 to 36 months. A provision for estimated future costs and estimated returns for credit relating to warranty is recorded when products are shipped and revenue recognized. Our estimate of future costs to satisfy warranty obligations is primarily based on historical trends and, if believed to be significantly different from historical trends, estimates of future failure rates and future costs of repair including materials consumed in the repair, labor and overhead amounts necessary to perform the repair. If future actual failure rates differ from our estimates, we record the impact in subsequent periods. If future actual costs to repair were to differ significantly from our estimates, we record the impact of these unforeseen cost differences in subsequent periods.

NOTE 8: RESTRUCTURING CHARGES

In fiscal 2011 and continuing in fiscal 2012, restructuring actions to consolidate operations supporting the business were the result of strategic management decisions. We did not incur restructuring charges in the third quarter of fiscal 2012 or 2011. The types of restructuring expense (benefit) for the nine months ended December 31, 2011 and 2010 were (in thousands):

	Nine Months Ended	
	December 31, 2011	December 31, 2010
By expense (benefit) type		
Severance and benefits	$ 375	$ 549
Facilities	324	(538)
Other	(300)	
Total	$ 399	$ 11

Fiscal 2012

During the first nine months of fiscal 2012, we accrued severance charges for various positions eliminated worldwide. Facility restructuring charges for the first nine months of fiscal 2012 were due to estimated charges for a facility in India that we vacated in the second quarter of fiscal 2012. The other restructuring reversal for the first nine months of fiscal 2012 was due to actual payments lower than estimated on a supplier relationship exited in fiscal 2011.

Fiscal 2011

For the nine months ended December 31, 2010, severance and benefits expense from additional positions eliminated was mostly offset by facility reversals. The facility reversals were primarily due to negotiating settlements for lease liabilities on two vacated facilities in the U.S. for amounts lower than the outstanding lease contracts.

Accrued Restructuring

The following tables show the activity and the estimated timing of future payouts for accrued restructuring (in thousands):

	For the three months ended December 31, 2011		
	Severance and Benefits	**Facilities**	**Total**
Balance as of September 30, 2011	$ 608	$ 668	$ 1,276
Cash payments	(461)	(126)	(587)
Balance as of December 31, 2011	$ 147	$ 542	$ 689

	For the nine months ended December 31, 2011			
	Severance and Benefits	**Facilities**	**Other**	**Total**
Balance as of March 31, 2011	$ 2,885	$ 843	$ 300	$ 4,028
Restructuring charges	554	324		878
Reversals	(179)		(300)	(479)
Cash payments	(3,136)	(625)		(3,761)
Assumed restructuring liability	23			23
Balance as of December 31, 2011	$ 147	$ 542	$	$ 689

	Severance and Benefits	**Facilities**	**Other**	**Total**
Estimated timing of future payouts:				
Fiscal 2012	$ 147	$ 102	$	$ 249
Fiscal 2013 to 2016		440		440
	$ 147	$ 542	$	$ 689

NOTE 9: STOCK INCENTIVE PLANS AND SHARE-BASED COMPENSATION
Overview

Our stock incentive plans (Plans) are broad-based, long-term retention programs that are intended to attract and retain talented employees and align stockholder and employee interests. The Plans provide for the issuance of stock options, stock appreciation rights, stock purchase rights and long-term performance awards to our employees, officers and affiliates. We also have an employee stock purchase plan (Purchase Plan) that allows for the purchase of stock at 85% of fair market value at the date of grant or the exercise date, whichever value is less.

During the first quarter of fiscal 2012, we assumed outstanding unvested options and unvested restricted shares of Pancetera which were exchanged into options and unvested restricted shares of Quantum common stock, respectively, in accordance with the merger agreement. As of June 13, 2011, Pancetera had approximately 0.8 million unvested stock options and 0.5 million unvested restricted shares outstanding. Based on the exchange ratio of 0.2403 calculated in accordance with the formula in the merger agreement, we assumed the outstanding unvested options, which are exercisable for an aggregate of 194,000 shares of Quantum common stock. Based on the relative cash and stock consideration for Pancetera shares per the merger agreement, the unvested restricted shares became 33,000 unvested restricted shares of Quantum common stock and $200,000 in cash held in escrow. The estimated fair value of unvested Pancetera options, unvested restricted shares and cash held in escrow related to future service is being recognized over the remaining service period.

The Black-Scholes option pricing model is used to estimate the fair value of options granted under our Plans, options assumed and rights to acquire stock granted under our Purchase Plan.

Share-Based Compensation

The following table summarizes share-based compensation (in thousands):

	Three Months Ended December 31, 2011	Three Months Ended December 31, 2010	Nine Months Ended December 31, 2011	Nine Months Ended December 31, 2010
Share-based compensation:				
Cost of revenue	$ 495	$ 459	$ 1,518	$ 1,363
Research and development	795	603	2,466	1,933
Sales and marketing	1,127	786	3,059	2,391
General and administrative	1,007	686	3,203	2,363
	$ 3,424	$ 2,534	$ 10,246	$ 8,050
Share-based compensation by type of award:				
Stock options	$ 583	$ 772	$ 2,116	$ 2,807
Restricted stock	2,377	1,287	6,586	3,988
Stock purchase plan	464	475	1,544	1,255
	$ 3,424	$ 2,534	$ 10,246	$ 8,050

Stock Options

No stock options were granted in the third quarter of fiscal 2012 and 2011. The weighted-average grant date fair values of employee stock option grants, as well as the weighted-average assumptions used in calculating these values for the first nine months of fiscal 2012 and 2011, were based on estimates at the date of grant as follows:

	Nine Months Ended December 31, 2011	Nine Months Ended December 31, 2010
Option life (in years)	4.0	4.2
Risk-free interest rate	1.57%	2.02%
Stock price volatility	112.33%	106.75%
Weighted-average grant date fair value	$ 1.91	$ 1.96

The weighted-average fair value of stock options assumed from Pancetera, as well as the weighted-average assumptions used in calculating these values were based on estimates at the acquisition date as follows:

Option life (in years)	5.2
Risk-free interest rate	1.65%
Stock price volatility	100.93%
Weighted-average grant date fair value	$ 2.67

The assumed options have a 10 year contractual life from the original grant date.

Restricted Stock

The fair value of the restricted stock units granted is the intrinsic value as of the respective grant date since the restricted stock units are granted at no cost to the employees. The weighted-average grant date fair values of restricted stock units granted during the third quarter and first nine months of fiscal 2012 were $2.27 and $3.15, respectively. The weighted-average grant date fair values of restricted stock units granted during the third quarter and first nine months of fiscal 2011 were $2.73 and $1.95, respectively.

Stock Purchase Plan

Under the Purchase Plan, rights to purchase shares are typically granted during the second and fourth quarter of each fiscal year. The value of rights to purchase shares granted in the first nine months of fiscal 2012 and fiscal 2011, respectively, was estimated at the date of the grant. The weighted-average grant date fair values and the assumptions used in calculating fair values for the nine month periods ended December 31, 2011 and 2010 are as follows:

	Nine Months Ended December 31, 2011	December 31, 2010
Option life (in years)	0.5	0.5
Risk-free interest rate	0.08%	0.20%
Stock price volatility	56.27%	66.91%
Weighted-average grant date fair value	$ 0.54	$ 0.48

Stock Activity

Stock Options

A summary of activity relating to our stock options follows (options and aggregate intrinsic value in thousands):

	Options	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term	Aggregate Intrinsic Value
Outstanding as of March 31, 2011	22,080	$ 2.43		
Granted and assumed	1,619	2.33		
Exercised	(2,660)	1.87		
Forfeited	(558)	1.88		
Expired	(488)	9.01		
Outstanding as of December 31, 2011	19,993	$ 2.35	2.94	$ 10,657
Vested and expected to vest at December 31, 2011	19,689	$ 2.35	2.90	$ 10,501
Exercisable as of December 31, 2011	16,483	$ 2.49	2.43	$ 7,804

Restricted Stock

A summary of activity relating to our restricted stock follows (shares in thousands):

	Shares	Weighted-Average Grant Date Fair Value
Nonvested at March 31, 2011	6,640	$ 1.95
Granted and assumed	6,611	3.14
Vested	(2,656)	1.80
Forfeited	(936)	2.56
Nonvested at December 31, 2011	9,659	$ 2.75

NOTE 10: INCOME TAXES

Income tax provisions for the third quarter and first nine months of fiscal 2012 were $0.5 million and $1.4 million, respectively. The tax benefit for the third quarter of fiscal 2011 was $0.7 million and the tax expense for the first nine months of fiscal 2011 was $0.1 million. Income tax provisions for the third quarter and first nine months of fiscal 2012 reflect expenses for foreign income taxes and state taxes. The tax benefit for the third quarter of fiscal 2011 was primarily due to the release of tax liabilities in foreign jurisdictions. The tax expense for the first nine months of fiscal 2011 was primarily comprised of foreign income taxes and state taxes largely reduced by the release of tax liabilities in foreign jurisdictions.

11

We have provided a full valuation allowance against our U.S. net deferred tax assets due to our history of net losses, difficulty in predicting future results and our conclusion that we cannot rely on projections of future taxable income to realize the deferred tax assets. Significant management judgment is required in determining our deferred tax assets and liabilities and valuation allowances for purposes of assessing our ability to realize any future benefit from our net deferred tax assets. We intend to maintain this valuation allowance until sufficient positive evidence exists to support a reversal or decrease in this allowance. Future income tax expense will be reduced to the extent that we have sufficient positive evidence to support a reversal of, or decrease in, our valuation allowance.

NOTE 11: NET INCOME PER SHARE

The following is our computation of basic and diluted net income per share (in thousands, except per-share data):

	Three Months Ended		Nine Months Ended	
	December 31, 2011	December 31, 2010	December 31, 2011	December 31, 2010
Net income	$ 3,914	$ 5,864	$ 2,249	$ 6,193
Weighted average shares and common share equivalents (CSE):				
Basic	233,812	222,801	231,661	219,052
Dilutive CSE from stock plans	5,622	11,189	7,101	8,318
Dilutive CSE from ESPP	478	1,109	499	784
Diluted	239,912	235,099	239,261	228,154
Basic and diluted net income per share	$ 0.02	$ 0.03	$ 0.01	$ 0.03

The computations of diluted net income per share for the periods presented exclude the following because the effect would have been anti-dilutive:

- For the third quarter and first nine months of fiscal 2012, 31.2 million weighted equivalent shares for the convertible subordinated notes were excluded. For the third quarter and first nine months of fiscal 2011, 15.6 million and 5.2 million weighted equivalent shares, respectively, for the convertible subordinated notes were excluded.
- For the third quarter and first nine months of fiscal 2012, options to purchase 9.2 million and 9.5 million weighted average shares, respectively, were excluded. For the third quarter and first nine months of fiscal 2011, options to purchase 4.4 million and 11.6 million weighted average shares, respectively, were excluded.
- Unvested restricted stock and restricted stock units of 5.3 million and 3.7 million weighted average shares for the third quarter and first nine months of fiscal 2012, respectively, were excluded. Negligible unvested restricted stock units were excluded for the third quarter of fiscal 2011. Unvested restricted stock units for 0.4 million weighted average shares for the first nine months of fiscal 2011 were excluded.

NOTE 12: COMPREHENSIVE INCOME

Total comprehensive income, net of tax, if any, for the three and nine months ended December 31, 2011 and 2010 was (in thousands):

	Three Months Ended		Nine Months Ended	
	December 31, 2011	December 31, 2010	December 31, 2011	December 31, 2010
Net income	$ 3,914	$ 5,864	$ 2,249	$ 6,193
Net unrealized gains (losses) on revaluation of long-term intercompany balance	(48)	58	63	42
Foreign currency translation adjustment	(334)	(147)	(819)	312
Total comprehensive income	$ 3,532	$ 5,775	$ 1,493	$ 6,547

NOTE 13: LEGAL PROCEEDINGS

On September 12, 2011, Compression Technology Solutions LLC (CTS) filed a patent infringement lawsuit against a group of companies, consisting of Quantum, CA., Inc., EMC Corporation, Hewlett-Packard Company, International Business Machines Corp., NetApp, Inc. and Quest Software, Inc., in the U.S. District Court in the Eastern District of Missouri, alleging that certain unspecified products of the defendants, characterized as deduplication software systems, and, in the case of Quantum, including Quantum s DXi Series Deduplication software, fall within the scope of patent 5,414,650. CTS is seeking injunctive relief, as well as the recovery of monetary damages, including treble damages for willful infringement. We do not believe we infringe the CTS patent; we believe that the CTS patent is invalid, and we intend to defend ourselves vigorously. Due to the inherent uncertainty of litigation, we cannot identify probable or estimable damages related to the lawsuit.

ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

FORWARD-LOOKING STATEMENT

This report contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Forward-looking statements in this report usually contain the words will, estimate, anticipate, expect, believe, project or similar expressions and variations or negatives of these words. All such forward-looking statements including, but not limited to, (1) our expectations relating to growing our branded disk systems and software solutions and branded tape automation systems revenue; (2) our expectation that we will continue to derive a substantial majority of our revenue from products based on tape technology; (3) our belief that our existing cash and capital resources will be sufficient to meet all currently planned expenditures, debt repayments and sustain our operations for at least the next 12 months; (4) our expectations regarding our ongoing efforts to control our cost structure; (5) our belief that our ultimate liability in any infringement claims made by any third parties against us will not be material to us; (6) our expectations regarding patent infringement actions; and (7) our business goals, objectives, key focuses, opportunities and prospects which are inherently uncertain as they are based on management s expectations and assumptions concerning future events, and they are subject to numerous known and unknown risks and uncertainties. Readers are cautioned not to place undue reliance on these forward-looking statements, about which we speak only as of the date hereof. As a result, our actual results may differ materially from the forward-looking statements contained herein. Factors that could cause actual results to differ materially from those described herein include, but are not limited to: (1) the amount of orders received in future periods; (2) our ability to timely ship our products; (3) uncertainty regarding information technology spending and the corresponding uncertainty in the demand for our products and services; (4) our ability to maintain supplier relationships; (5) the successful execution of our strategy to expand our business in new directions; (6) our ability to successfully introduce new products; (7) our ability to capitalize on changes in market demand; (8) our ability to achieve anticipated gross margin levels; (9) U.S. and global macroeconomic conditions; and (10) those factors discussed under Risk Factors in Part II, Item 1A. Our forward-looking statements are not guarantees of future performance. We disclaim any obligation to update information in any forward-looking statement.

OVERVIEW

Quantum Corporation (Quantum , the Company , us or we), founded in 1980, is a global expert in data protection and big data management. Combining focused expertise, customer-driven innovation and platform independence, we provide a comprehensive, integrated range of disk, tape and software solutions to solve data protection and big data management challenges supported by our sales and service organization. We work closely with a broad network of distributors, value-added resellers (VARs), direct marketing resellers, original equipment manufacturers (OEMs) and other suppliers to meet customers evolving data protection and big data management needs. Our stock is traded on the New York Stock Exchange (NYSE) under the symbol QTM.

We offer a comprehensive range of solutions for data protection and big data management challenges providing performance and value to organizations of all sizes, from small businesses to multinational enterprises. We believe our combination of expertise, innovation and platform independence allows us to solve customers data protection and big data management issues more easily, cost-effectively and securely. Our open systems solutions are designed to provide significant storage efficiencies and cost savings while minimizing risk and protecting customers prior investments. They include the DXi®-Series disk-based deduplication and replication systems for fast backup and restore, Scalar® tape automation products for disaster recovery and long-term data retention, StorNext® data management software and appliances for high-performance file sharing and archiving and vmPRO solutions for protecting virtual machine data. In addition, we have the global scale and scope to support our worldwide customer base. We offer a full range of service with support available in more than 100 countries.

We earn our revenue from the sale of products, systems and services through an array of channel partners and our sales force to reach end user customers, which range in size from small businesses to multinational enterprises. Our products are sold under both the Quantum brand name and the names of various OEM customers. We have a broad portfolio of disk systems, software solutions, tape automation systems, tape drives and other devices and media. Our data management software provides technology for shared workflow applications and multi-tiered archiving in high-performance, large-scale storage environments. We also offer vmPRO software, a virtualization data protection software with advanced utilities designed to dramatically improve and simplify virtual data protection in midrange and larger data centers. The majority of our disk systems and tape automation systems include software features that provide disk and tape integration capabilities with our core deduplication and replication technologies. In addition, our service offerings include a broad range of coverage options to provide the level of support for the widest possible range of information technology (IT) environments.

We have implemented a number of initiatives in the past several quarters in an effort to drive branded revenue growth. One key initiative for fiscal 2012 has been to grow the independent channel for Quantum branded products. Another key area of focus for fiscal 2012 is continuing to expand and improve our products and solutions, with emphasis on branded disk systems and software solutions, including introducing and ramping sales of the StorNext appliance family and virtual offerings in addition to expanding professional services and custom engineering. We believe our current tape automation systems, disk systems and software solutions provide excellent value propositions for customers and we plan to continue to expand the breadth and depth of our product and service offerings. We are focused on advancing these objectives to take advantage of our improved position in the markets in which we participate to grow revenue and create shareholder value.

We stated that for the third quarter of fiscal 2012, we were focused on continuing to grow revenue by expanding the breadth of our product portfolio, including the introduction of several new products as well as continuing to increase sales through channel partners. We began to position our products as they relate to the data protection and the big data management and archive markets. Our data protection solutions include our DXi-Series family of products, Scalar tape automation products, devices and media as well as virtual environment offerings that include vmPRO software and vmPRO appliances. The products that address the big data management and archive market include StorNext software and our StorNext appliances.

In the third quarter of fiscal 2012, we introduced several new products and continued to increase channel traction. Branded revenue grew 3% from the third quarter of fiscal 2011 due to adding new customers, increasing our channel traction and revenue contributions from new products. New customer acquisitions were strong in the data protection market, with notable new customers for midrange and enterprise tape automation products and for disk systems. Our focus on growing our existing channel and deepening our relationships with those partners continued in the third quarter of fiscal 2012. These efforts to increase sales through channel partners were reflected in increased disk systems revenue from sales through the independent channel, more channel partners selling disk solutions and a greater number of new customers obtained through the channel compared to the third quarter of fiscal 2011.

As noted above, one key area of focus is continuing to expand and improve our products and solutions, with emphasis on branded disk systems and software solutions, including additional StorNext appliances. During the third quarter of fiscal 2012, we continued to expand and improve our product portfolio. Notable new data protection solutions introduced during the quarter included the DXi4601, the vmPRO 4601 appliance, the NDX NAS appliance and the RDX removable disk library. In addition, we added dual robot functionality to the Scalar i6000 and in mid-December, released DXi 2.1 software on the DXi8500. New products introduced in the third quarter of fiscal 2012 that address the big data management and archive market included our midrange StorNext Archive Enabled Library (SAEL) solution, and we began shipping our Q-Series storage systems. A number of products within our portfolio received industry recognition during the third quarter of fiscal 2012, including awards for quality. We believe that our sales execution has improved as a result of our improved product portfolio, increasing our market opportunities and awareness with end users.

Our big data management strategy is a key to our overall growth objectives. Revenue from big data management and archive products increased 18% from the third quarter of fiscal 2011 and 6% sequentially. Our StorNext software offering serves the needs of our install base customers and traditional use cases where users have decided on their hardware choices and want to deploy StorNext to create their solution. Our StorNext appliances enable us to broaden the available market and more deeply penetrate new market segments by allowing customers to purchase the whole solution from us.

For the fourth quarter of fiscal 2012, we are focused on continuing to enhance our relationships with existing partners and adding new partners. In addition, we are launching an initiative to grow revenue from products and solutions for small and medium businesses. The small and medium business market segment is one in which we historically had been strong; however, that market has evolved over the years and, in many cases, moved to other technologies. We have introduced several new products including the DXi4601, vmPRO 4601 and NAS and RDX solutions that along with our existing tape automation products, we believe provide more relevant and valuable solutions to small and medium businesses. Another initiative we are implementing in the fourth quarter of fiscal 2012 is to expand end user awareness of our data protection and our big data management and archive solutions. We expect to continue these initiatives into fiscal 2013 to increase revenue from our data protection and big data and archive solutions, including revenue from solutions for the small and medium business market. The fourth fiscal quarter is historically a seasonally weak quarter, and we recognize continued risk from economic uncertainly, particularly in Europe. However, we believe the key to revenue growth for us is to continue to leverage our expertise as well as our intelligent and unique solutions to provide customers superior value to meet their needs in data protection and big data management and archive. We continue to focus on increasing revenue from our branded products, especially disk systems and software solutions.

Results

Revenue decreased $2.7 million, or 2%, in the third quarter of fiscal 2012 compared to the third quarter of fiscal 2011 primarily due to expected reductions in OEM and royalty revenue. Product revenue from OEM customers decreased 12% while revenue from branded products increased 5% from the third quarter of fiscal 2011 due to continued improvement in sales volumes through our partners. The royalty revenue decrease was primarily from maturing DLT media. Our efforts to increase revenue from branded disk systems and software solutions resulted in an 18% increase from the third quarter of fiscal 2011, primarily due to the addition of revenue from the recently introduced family of StorNext appliances, such as the StorNext Archive Enabled Library products, and midrange disk system revenue increases. In addition, branded tape automation revenue increased 1% in a declining market, an indicator of growing our market share. Service revenue decreased primarily due to a decline in OEM repair activity and lower hardware service contract revenues from end of service life on higher revenue service contracts for certain legacy branded tape automation products. Our focus on growing the branded business in recent years is reflected in the greater proportion of non-royalty revenue from our branded business, at 81% in the third quarter of fiscal 2012 compared to 78% in the third quarter of fiscal 2011.

Our gross margin percentage decreased 40 basis points in the third quarter of fiscal 2012 to 42.5% primarily due to decreased revenue and changes in our revenue mix, including decreased royalty revenue, mostly offset by decreased intangible amortization. Product gross margin percentage increased 70 basis points from the third quarter of fiscal 2011, primarily due to decreased intangible amortization. Service gross margin percentage decreased 160 basis points primarily due to the loss of higher revenue service contracts for certain legacy branded tape automation products that reached end of life.

Operating expenses increased 4% to $66.7 million for the third quarter of fiscal 2012 primarily due to increased salaries and benefits from investing in our sales and marketing and general and administrative teams. Income from operations was $7.0 million for a 4.0% operating margin in the third quarter of fiscal 2012 compared to a 6.5% operating margin in the third quarter of fiscal 2011. The largest contributor to the decline in operating margin was decreased revenue, specifically lower service revenue and royalty revenue, followed by incremental operating expenses in the third quarter of fiscal 2012.

Interest expense decreased $2.3 million, or 49%, compared to the third quarter of fiscal 2011 primarily due to refinancing higher rate subordinated term debt with convertible subordinated notes in fiscal 2011 and to a lesser extent from principal prepayments of senior term debt. We generated $16.1 million in cash from operating activities in the third quarter of fiscal 2012 and ended the quarter with $63.2 million in cash and cash equivalents, including restricted cash. Our outstanding senior term debt balance was $68.6 million at December 31, 2011.

RESULTS OF OPERATIONS

Revenue

(In thousands)	**Three Months Ended December 31, 2011**	**% of revenue**	**December 31, 2010**	**% of revenue**	**Change**	**% Change**
Product revenue	$ 124,081	71.5%	$ 123,218	69.9%	$ 863	0.7%
Service revenue	35,362	20.4%	37,365	21.2%	(2,003)	(5.4)%
Royalty revenue	14,049	8.1%	15,643	8.9%	(1,594)	(10.2)%
Total revenue	$ 173,492	100.0%	$ 176,226	100.0%	$ (2,734)	(1.6)%

	Nine Months Ended December 31, 2011	**% of revenue**	**December 31, 2010**	**% of revenue**	**Change**	**% Change**
Product revenue	$ 341,475	69.4%	$ 344,001	67.9%	$ (2,526)	(0.7)%
Service revenue	107,956	21.9%	113,730	22.4%	(5,774)	(5.1)%
Royalty revenue	42,635	8.7%	49,442	9.7%	(6,807)	(13.8)%
Total revenue	$ 492,066	100.0%	$ 507,173	100.0%	$ (15,107)	(3.0)%

Total revenue decreased in the third quarter and first nine months of fiscal 2012 primarily due to anticipated decreases in OEM and royalty revenue. However, branded revenue increased from the third quarter and first nine months of fiscal 2011 primarily due increased branded disk and software sales. Branded product revenue increases compared to the third quarter of fiscal 2011 were primarily in Asia and to a lesser extent in North America.

Product Revenue

Our product revenue, which includes sales of our hardware and software products sold through both our Quantum branded and OEM channels, increased $0.9 million from the third quarter of fiscal 2011 primarily due to increased branded disk systems and software solutions revenue, largely offset by anticipated decreases in OEM revenue. Product revenue decreased $2.5 million compared to the first nine months of fiscal 2011 primarily due to an anticipated decrease in OEM deduplication software revenue, partially offset by an increase in branded disk systems and software solutions revenue. The relationship with a significant OEM customer for deduplication software changed from partner to competitor due to its purchase of one of our competitors in a prior year. Revenue from sales of branded products increased 5% in the third quarter of fiscal 2012 and 6% in the first nine months of fiscal 2012 compared to the respective prior year periods.

(In Thousands)	Three Months Ended December 31, 2011	% of revenue	December 31, 2010	% of revenue	Change	% Change
Disk systems and software solutions	$ 31,712	18.3%	$ 26,868	15.2%	$ 4,844	18.0%
Tape automation systems	70,489	40.6%	72,482	41.1%	(1,993)	(2.7)%
Devices and media	21,880	12.6%	23,868	13.6%	(1,988)	(8.3)%
Product revenue	$ 124,081	71.5%	$ 123,218	69.9%	$ 863	0.7%

	Nine Months Ended December 31, 2011	% of revenue	December 31, 2010	% of revenue	Change	% Change
Disk systems and software solutions	$ 86,543	17.6%	$ 85,088	16.8%	$ 1,455	1.7%
Tape automation systems	190,634	38.7%	192,030	37.9%	(1,396)	(0.7)%
Devices and media	64,298	13.1%	66,883	13.2%	(2,585)	(3.9)%
Product revenue	$ 341,475	69.4%	$ 344,001	67.9%	$ (2,526)	(0.7)%

As noted earlier, a primary goal for fiscal 2012 is to grow revenue from disk systems and software solutions. For the third quarter of fiscal 2012, disk systems and software solutions revenue increased 18% compared to the third quarter of fiscal 2011 primarily due to the addition of revenue from our StorNext appliances as well as increased sales of our midrange disk systems. As a result of these revenue increases, disk systems and software solutions comprised a greater proportion of total revenue in the third quarter of fiscal 2012 compared to the prior year period. These increases were partially offset by a decrease in enterprise disk systems revenue.

For the first nine months of fiscal 2012, disk systems and software solutions revenue increased 2% primarily from increased midrange disk systems sales and the addition of StorNext appliance revenue. Midrange disk system sales increased 48%, largely from our DXi6700 family of products, and branded software and appliance revenue increased 18% from the third quarter of fiscal 2011. These increases were largely offset by the expected decrease in OEM deduplication software revenue due to revenue recognized in accordance with contractual requirements in the first quarter of fiscal 2011 and to a lesser extent from decreased enterprise disk systems revenue due to fewer large orders. Enterprise disk systems revenue was lower than planned primarily due to lower revenue from our legacy enterprise disk product, and to a lesser extent from decreased sales of the DXi 8500.

Tape automation systems revenue decreased 3% and 1% from the third quarter and first nine months of fiscal 2011, respectively, primarily due to expected decreases in sales to OEM customers. For the third quarter of fiscal 2012, OEM tape automation systems revenues from enterprise, midrange and entry-level products each decreased by a similar amount. For the first nine months of fiscal 2012, midrange and entry level tape automation systems revenue from OEM customers decreased as anticipated compared to the prior year period, while OEM enterprise tape automation product sales increased compared to the prior year. Largely offsetting these decreases, we had branded tape automation systems revenue increases of 1% and 4% in the third quarter and first nine months of fiscal 2012, respectively, primarily due to increased enterprise sales and to a lesser extent from midrange sales.

Product revenue from devices, which includes tape drives and removable hard drives, and non-royalty media sales declined 8% and 4% from the third quarter and first nine months of fiscal 2011, respectively, primarily due to decreased sales of older technology devices, including branded and OEM devices that reached, or are nearing, end of life. These decreases were partially offset by increased branded media sales in the third quarter and first nine months of fiscal 2012 compared to the same periods in fiscal 2011. The increase in branded media revenue is primarily due to the events in Japan earlier this year and resulting concern of shortages and supply disruption in the market. Consistent with our expectations, revenue from OEM devices and media has become an immaterial part of our overall revenue mix.

Service Revenue

Service revenue includes revenue from sales of hardware service contracts, product repair, installation and professional services. Hardware service contracts are typically purchased by our customers to extend their warranties, to provide faster service response times, or both. Service revenue decreased 5% in both the third quarter and the first nine months of fiscal 2012 compared to the prior year periods primarily due to lower hardware service contract revenues from end of service life on higher revenue service contracts for certain legacy branded tape automation products and from decreased OEM product repair services. *S*ervice contracts on newer technology products provide lower revenue than service contracts on certain older technology products nearing end of service life.

Royalty Revenue

Tape media royalties decreased 10% and 14% in the third quarter and first nine months of fiscal 2012, respectively, compared to the third quarter and first nine months of fiscal 2011 primarily due to expected decreases of maturing DLT media sold by media licensees. These decreases were largely from a continued worldwide decline in demand for older media technology.

Gross Margin

(In thousands)	**Three Months Ended**					
	December 31, 2011	**Gross margin %**	**December 31, 2010**	**Gross margin %**	**Change**	**% Change**
Product gross margin	$ 46,843	37.8%	$ 45,762	37.1%	$ 1,081	2.4%
Service gross margin	12,825	36.3%	14,165	37.9%	(1,340)	(9.5)%
Royalty gross margin	14,049	100.0%	15,643	100.0%	(1,594)	(10.2)%
Gross margin	$ 73,717	42.5%	$ 75,570	42.9%	$ (1,853)	(2.5)%

	Nine Months Ended					
	December 31, 2011	**Gross margin %**	**December 31, 2010**	**Gross margin %**	**Change**	**% Change**
Product gross margin	$ 123,431	36.1%	$ 122,843	35.7%	$ 588	0.5%
Service gross margin	42,224	39.1%	42,135	37.0%	89	0.2%
Royalty gross margin	42,635	100.0%	49,442	100.0%	(6,807)	(13.8)%
Gross margin	$ 208,590*	42.4%	$ 214,420	42.3%	$ (5,830)	(2.7)%

*Gross margin for the nine months ended December 31, 2011 includes $0.3 million of restructuring benefit related to cost of revenue.

The 40 basis point decrease in gross margin percentage for the third quarter of fiscal 2012 compared to the third quarter of fiscal 2011 was the net result of largely offsetting factors. The primary factor decreasing gross margin was lower total revenue and changes in our revenue mix, including decreased royalty revenue. Largely offsetting this was a decrease in intangible amortization expense due to certain intangibles becoming fully amortized during fiscal 2011 and 2012. The gross margin percentage in the first nine months of fiscal 2012 compared to the first nine months of fiscal 2011 was essentially unchanged and also the net result of offsetting factors. The primary factor increasing gross margin percentage for the first nine months of fiscal 2012 was decreased intangible amortization expense from certain intangibles becoming fully amortized. This was offset by decreased OEM deduplication software revenue as noted earlier and lower royalty revenue in the first nine months of fiscal 2012 compared to the first nine months of fiscal 2011.

We had an increased percentage of products sold through our branded channels compared to the third quarter and first nine months of fiscal 2011. Branded sales comprised 81% of non-royalty revenue for both the third quarter and first nine months of fiscal 2012 compared to 78% and 77% for the third quarter and first nine months of fiscal 2011, respectively. Sales of branded products typically generate higher gross margins than sales to our OEM customers; however, OEM deduplication software revenue provides one of our highest product margins.

Product Margin

Product gross margin dollars increased $1.1 million, or 2%, on a product revenue increase of 1% compared to the third quarter of fiscal 2011, and our product gross margin rate increased 70 basis points. These increases were primarily due to decreased intangible amortization expense, partially offset by changes in our product revenue mix. For the first nine months of fiscal 2012, product gross margin dollars increased slightly and the product gross margin rate increased 40 basis points primarily due to decreased intangible amortization expense for the first nine months of fiscal 2012, mostly offset by a decrease in high margin OEM deduplication software revenue compared to the first nine months of fiscal 2011.

Service Margin

Service gross margin dollars decreased $1.3 million and service gross margin percentage decreased 160 basis points primarily due to a $2.0 million decrease in service revenue in the third quarter of fiscal 2012, including the loss of higher revenue service contracts for certain legacy branded tape automation products that have reached end of life compared to the third quarter of fiscal 2011. Partially offsetting the lower service margin dollars was reduced costs for external service providers as a result of bringing repair of certain product lines in-house that previously were repaired by external service providers.

For the first nine months of fiscal 2012, service gross margin dollars were unchanged while the service gross margin percentage increased 210 basis points despite a decrease in service revenue of $5.8 million. The increased service margin percentage was primarily due to reduced costs from lower inventory allowance expense. We had higher inventory allowance expense in the first nine months of fiscal 2011 due to end of service life plans for several products. In addition, we had a decrease in external service provider expense compared to the first nine months of fiscal 2011 and a change in the mix of services for OEM repairs and for our branded products under contract. External service provider expense decreased due to a combination of bringing repair of certain product lines in-house and negotiating lower rates on the renewals of contracts with certain service providers. Our service activities for the first nine months of fiscal 2012 reflected a greater proportion of revenue from branded products under contract, which have relatively higher margins than margins for OEM repair services.

Research and Development Expenses

(In thousands)	Three Months Ended December 31, 2011	% of revenue	December 31, 2010	% of revenue	Change	% Change
Research and development	$ 17,629	10.2%	$ 18,240	10.4%	$ (611)	(3.3)%

	Nine Months Ended December 31, 2011	% of revenue	December 31, 2010	% of revenue	Change	% Change
Research and development	$ 55,212	11.2%	$ 54,490	10.7%	$ 722	1.3%

The decrease in research and development expenses compared to the third quarter of fiscal 2011 was primarily due to $0.2 million reductions in both small equipment expense and travel expense. Research and development projects during the third quarter of fiscal 2011 required more equipment than was required for projects under development during the third quarter of fiscal 2012.

The increase in research and development expenses compared to the first nine months of fiscal 2011 was primarily due to a $1.1 million increase in salaries and benefits from investments in our disk systems and software development teams for new product development efforts, partially offset by a $0.4 million decrease in licensing costs from an agreement that concluded in the prior year.

Sales and Marketing Expenses

(In thousands)	Three Months Ended December 31, 2011	% of revenue	December 31, 2010	% of revenue	Change	% Change
Sales and marketing	$ 33,350	19.2%	$ 31,776	18.0%	$ 1,574	5.0%

	Nine Months Ended December 31, 2011	% of revenue	December 31, 2010	% of revenue	Change	% Change
Sales and marketing	$ 94,990	19.3%	$ 90,973	17.9%	$ 4,017	4.4%

The increase in sales and marketing expense for the third quarter and first nine months of fiscal 2012 was largely due to a $1.3 million and $4.2 million increase, respectively, in compensation and benefits primarily due to increased commissionable revenue.

General and Administrative Expenses

(In thousands)	Three Months Ended December 31, 2011	% of revenue	December 31, 2010	% of revenue	Change	% Change
General and administrative	$ 15,759	9.1%	$ 14,176	8.0%	$ 1,583	11.2%

	Nine Months Ended December 31, 2011	% of revenue	December 31, 2010	% of revenue	Change	% Change
General and administrative	$ 46,991	9.5%	$ 44,600	8.8%	$ 2,391	5.4%

The increase in general and administrative expenses for the third quarter and first nine months of fiscal 2012 compared to the third quarter and first nine months of fiscal 2011 was primarily due to a $0.6 million and $1.6 million increase in salaries and benefits, respectively, from the prior year periods. Stock compensation expense was the largest component of increased salaries and benefits for both the third quarter and first nine months of fiscal 2012 largely due to grants in fiscal 2012 for promotions and merit increases. In addition, in the third quarter of fiscal 2012 we had a $0.3 million increase in legal expense, a $0.3 million increase in net value-added tax (VAT) provisions and a $0.3 million net increase in bad debt expense. The increased legal expense was due to efforts to defend ourselves against the patent infringement lawsuit brought by Compression Technology Solutions LLC (CTS). Increased VAT provisions were due to interest income received on VAT refunds during the third quarter of fiscal 2011 that did not repeat in fiscal 2012. Bad debt expense was higher in the third quarter of 2012 as a result of lower allowance for doubtful accounts requirements in the third quarter of fiscal 2011. For the first nine months of fiscal 2012, we also had an increase of $0.6 million in facility expenses primarily due to refurbishing costs that were higher than estimated at lease inception for certain facilities returned to their respective lessors at the end of the lease terms.

The patent infringement lawsuit brought by CTS is discussed in more detail in Note 13: Legal Proceedings. Due to the inherent uncertainty of litigation, we cannot identify probable or estimable damages related to the lawsuit at this time. We may incur higher than typical legal costs to defend ourselves while the lawsuit is ongoing.

Restructuring Charges

	Nine Months Ended December 31, 2011	% of revenue	December 31, 2010	% of revenue	Change	% Change
Restructuring benefit related to cost of revenue	$ (300)	(0.1)%	$	%	$ (300)	n/m
Restructuring charges in operating expense	699	0.1%	11	%	688	n/m
Total restructuring charges	$ 399	0.1%	$ 11	%	$ 388	n/m

The increase in restructuring charges for the first nine months of fiscal 2012 was primarily due to facility restructuring charges for a facility vacated in India in the second quarter of fiscal 2012 compared to benefits in the first nine months of fiscal 2011 from negotiated lease settlements for amounts lower than the outstanding lease contracts. This increase in restructuring expense was partially offset by the restructuring benefit related to cost of revenue due to actual payments lower than estimated on a supplier relationship exited in fiscal 2011. For additional information, refer to Note 8: Restructuring Charges. We may incur additional charges in the future related to further cost reduction steps.

Gain on Sale of Patents

(In thousands)	Nine Months Ended December 31, 2011	% of revenue	December 31, 2010	% of revenue	Change	% Change
Gain on sale of patents	$ 1,500	0.3%	$	%	$ 1,500	n/m

In the second quarter of fiscal 2012, we had a $1.5 million gain on the sale of certain patents. Under the patent sale agreement, we retain a royalty-free license for these patents. We may enter into similar transactions in the future.

Interest Income and Other, Net

(In thousands)	Three Months Ended December 31, 2011	% of revenue	December 31, 2010	% of revenue	Change	% Change
Interest income and other, net	$ (142)	(0.1)%	$ (250)	(0.1)%	$ 108	43.2%

	Nine Months Ended December 31, 2011	% of revenue	December 31, 2010	% of revenue	Change	% Change
Interest income and other, net	$ (422)	(0.1)%	$ 24	%	$ (446)	n/m

The increase in interest income and other, net for the third quarter of fiscal 2012 was primarily due to $0.9 million in fees for an amendment to our senior secured credit agreement in the third quarter of fiscal 2011 that was not repeated. This was mostly offset by prior year gains on investments in private technology venture limited partnerships that were not repeated and net foreign exchange losses from the U.S. dollar strengthening against the euro and the Swiss franc in the third quarter of fiscal 2012.

The decrease in interest income and other, net for the first nine months of fiscal 2012 was primarily due to prior year gains on investments in private technology venture limited partnerships that were not repeated and, to a lesser extent, from net foreign exchange losses due to the U.S. dollar strengthening against the euro and Swiss franc during the first nine months of fiscal 2012 compared to the prior year period. This decrease was partially offset by $0.9 million in fees for an amendment to our senior secured credit agreement in the third quarter of fiscal 2011 that was not repeated.

Interest Expense

(In thousands)	Three Months Ended December 31, 2011	% of revenue	December 31, 2010	% of revenue	Change	% Change
Interest expense	$ 2,450	1.4%	$ 4,761	2.7%	$ (2,311)	(48.5)%

	Nine Months Ended December 31, 2011	% of revenue	December 31, 2010	% of revenue	Change	% Change
Interest expense	$ 8,111	1.6%	$ 16,877	3.3%	$ (8,766)	(51.9)%

Interest expense decreased in the third quarter and first nine months of fiscal 2012 primarily due to refinancing higher rate subordinated term debt with convertible subordinated debt in the third quarter of fiscal 2011 and to a lesser extent from principal payments reducing the outstanding balance of our senior term debt. Interest expense includes the amortization of debt issuance costs for our debt facilities.

Loss on Debt Extinguishment

(In thousands)	Three Months Ended December 31, 2011	% of revenue	December 31, 2010	% of revenue	Change	% Change
Loss on debt extinguishment	$	%	$ 1,186	0.7%	$ (1,186)	(100.0)%

	Nine Months Ended December 31, 2011	% of revenue	December 31, 2010	% of revenue	Change	% Change
Loss on debt extinguishment	$	%	$ 1,186	0.2%	$ (1,186)	(100.0)%

During the third quarter of fiscal 2011, we issued $135.0 million aggregate principal of 3.5% convertible subordinated notes. We used the proceeds from the issuance to fully repay our subordinated term debt. In connection with this debt extinguishment, we wrote off $1.2 million of unamortized debt costs related to the subordinated term debt.

Income Taxes

(In thousands)	Three Months Ended December 31, 2011	% of pre-tax income	December 31, 2010	% of pre-tax income	Change	% Change
Income tax provision (benefit)	$ 473	10.8%	$ (683)	(13.2)%	$ 1,156	n/m

	Nine Months Ended December 31, 2011	% of pre-tax income	December 31, 2010	% of pre-tax income	Change	% Change
Income tax provision	$ 1,416	38.6%	$ 114	1.8%	$ 1,302	n/m

Income tax provisions for the third quarter and first nine months of fiscal 2012 reflect expenses for foreign income taxes and state taxes. The tax benefit for the third quarter of fiscal 2011 was primarily due to the release of tax liabilities in foreign jurisdictions. The tax expense for the first nine months of fiscal 2011 was primarily comprised of foreign income taxes and state taxes largely reduced by the release of tax liabilities in foreign jurisdictions. We have provided a full valuation allowance against our U.S. net deferred tax assets due to our history of net losses, difficulty in predicting future results and our conclusion that we cannot rely on projections of future taxable income to realize the deferred tax assets.

Significant management judgment is required in determining our deferred tax assets and liabilities and valuation allowances for purposes of assessing our ability to realize any future benefit from our net deferred tax assets. We intend to maintain this valuation allowance until sufficient positive evidence exists to support a reversal or decrease in this allowance. Future income tax expense will be reduced to the extent that we have sufficient positive evidence to support a reversal of, or decrease in, our valuation allowance.

Amortization of Intangible Assets

The following tables detail intangible asset amortization expense within our Condensed Consolidated Statements of Operations (in thousands):

	Three Months Ended December 31, 2011	December 31, 2010	Change	% Change
Cost of revenue	$ 1,472	$ 2,574	$ (1,102)	(42.8)%
Sales and marketing	3,256	3,332	(76)	(2.3)%
General and administrative		25	(25)	(100.0)%
	$ 4,728	$ 5,931	$ (1,203)	(20.3)%

	Nine Months Ended December 31, 2011	December 31, 2010	Change	% Change
Cost of revenue	$ 6,148	$ 12,087	$ (5,939)	(49.1)%
Research and development		200	(200)	(100.0)%
Sales and marketing	9,872	10,088	(216)	(2.1)%
General and administrative	32	75	(43)	(57.3)%
	$ 16,052	$ 22,450	$ (6,398)	(28.5)%

The decrease in intangible expense in the third quarter and first nine months of fiscal 2012 compared to the third quarter and first nine months of fiscal 2011 was primarily due to certain intangibles becoming fully amortized during fiscal 2011 as well as in the second quarter of fiscal 2012. For further information regarding amortizable intangible assets, refer to Note 6: Intangible Assets and Goodwill.

Share-based Compensation

The following table summarizes share-based compensation within our Condensed Consolidated Statements of Operations (in thousands):

	Three Months Ended December 31, 2011	December 31, 2010	Change	% Change
Cost of revenue	$ 495	$ 459	$ 36	7.8%
Research and development	795	603	192	31.8%
Sales and marketing	1,127	786	341	43.4%
General and administrative	1,007	686	321	46.8%
	$ 3,424	$ 2,534	$ 890	35.1%

	Nine Months Ended December 31, 2011	December 31, 2010	Change	% Change
Cost of revenue	$ 1,518	$ 1,363	$ 155	11.4%
Research and development	2,466	1,933	533	27.6%
Sales and marketing	3,059	2,391	668	27.9%
General and administrative	3,203	2,363	840	35.5%
	$ 10,246	$ 8,050	$ 2,196	27.3%

The increase in share-based compensation for the third quarter and first nine months of fiscal 2012 compared to the third quarter and first nine months of fiscal 2011 was primarily due to an increase in restricted stock units granted in the second quarter of fiscal 2012, largely due to merit increases for our workforce.

LIQUIDITY AND CAPITAL RESOURCES

Following is a summary of cash flows from operating, investing and financing activities (in thousands):

	Nine Months Ended December 31, 2011	December 31, 2010
Net income	$ 2,249	$ 6,193
Net cash provided by operating activities	33,093	28,921
Net cash used in investing activities	(18,910)	(9,031)
Net cash used in financing activities	(30,830)	(43,686)

Nine Months Ended December 31, 2011

The $30.8 million difference between reported net income and cash provided by operating activities during the nine months ended December 31, 2011 was primarily due to $43.6 million in non-cash items, the largest of which were amortization, depreciation, share-based compensation and service parts lower of cost or market adjustment. In addition, we had a $7.1 million increase in accounts payable primarily due to the timing of payments and increased purchases. These were partially offset by a $17.5 million increase in manufacturing inventories primarily due to purchasing materials to meet projected third quarter fiscal 2012 product sales and from securing a sufficient supply of hard disk drives for forecast needs into early fiscal 2013 due to supply constraints from flooding in Thailand.

Cash used in investing activities reflects $8.5 million of equipment purchases during the first nine months of fiscal 2012 and $8.2 million of cash paid, net of cash acquired, for our acquisition of Pancetera. Equipment purchases were primarily for engineering equipment and testing hardware to support product development activities.

Cash used in financing activities during the first nine months of fiscal 2012 was primarily due to $35.7 million of principal payments on the senior term debt, partially offset by $7.5 million in proceeds received from the exercise of stock options and issuance of shares under the employee stock purchase plan.

Nine Months Ended December 31, 2010

The $22.7 million difference between reported net income and cash provided by operating activities during the nine months ended December 31, 2010 was primarily due to $52.3 million in non-cash expenses, the largest of which were amortization, depreciation, service parts lower of cost or market adjustment and share-based compensation. This was partially offset by a $15.4 million increase in accounts receivable and a $9.3 million decrease in deferred revenue. Accounts receivable increased primarily due to an increase in revenue in the third quarter of fiscal 2011 compared to the fiscal quarter ended March 31, 2010. The decrease in deferred revenue was primarily due to the final utilization of an OEM deduplication software prepayment during the first nine months of fiscal 2011.

Cash used in investing activities reflects $9.3 million of equipment purchases during the nine months ended December 31, 2010. Equipment purchases were primarily for engineering test equipment to support product development activities.

Cash used in financing activities during the first nine months of fiscal 2011 was primarily due to repaying a net $55.2 million of outstanding debt, partially offset by $13.6 million received from the issuance of common stock.

Capital Resources and Financial Condition

We have made progress in increasing operating income in recent periods, and we continue to focus on improving our operating performance, including increasing revenue in higher margin areas of the business and continuing to improve margins in an effort to return to consistent profitability and to generate positive cash flows from operating activities. We believe that our existing cash and capital resources will be sufficient to meet all currently planned expenditures, debt repayments, contractual obligations and sustain operations for at least the next 12 months. This belief is dependent upon our ability to achieve revenue and gross margin projections and to continue to control operating expenses in order to provide positive cash flow from operating activities. Should any of the above assumptions prove incorrect, either in combination or individually, it would likely have a material negative effect on our cash balances and capital resources.

The following is a description of our existing capital resources including outstanding balances, funds available to borrow, and primary repayment terms including interest rates.

Under the Credit Suisse credit agreement (CS credit agreement), we have the ability to borrow up to $50 million under a senior secured revolving credit facility which expires July 12, 2012. As of December 31, 2011, we have letters of credit totaling $0.1 million reducing the amounts available to borrow on this revolver to $49.9 million. Quarterly, we are required to pay a 0.5% commitment fee on undrawn amounts under the revolving credit facility.

Our outstanding term debt under the CS credit agreement was $68.6 million at December 31, 2011. This loan matures on July 12, 2014 and has a variable interest rate. The interest rate on the term loan was 3.80% at December 31, 2011. We are required to make quarterly interest and principal payments on the term loan. In addition, on an annual basis, we are required to perform a calculation of excess cash flow which may require an additional payment of the principal amount in certain circumstances. The annual calculations of excess cash flow have not required additional payments. There is a blanket lien on all of our assets under the CS credit agreement in addition to certain financial and reporting covenants. As of December 31, 2011, we were in compliance with all debt covenants.

We have $135 million aggregate principal amount outstanding of 3.50% convertible subordinated notes due November 15, 2015. Semi-annual interest payments are required on these notes.

Generation of positive cash flow from operating activities has historically been and will continue to be an important source of our cash to fund operating needs and meet our current and long-term obligations. We cannot provide assurance that the actions we have taken in the past or any actions we may take in the future to improve our operating results will ensure a consistent, sustainable and sufficient level of net income and positive cash flow from operating activities to fund, sustain or grow our businesses. Certain events that are beyond our control, including prevailing economic, competitive and industry conditions, as well as various legal and other disputes, may prevent us from achieving these financial objectives. Any inability to achieve consistent and sustainable net income and cash flow could result in:

(i) Restrictions on our ability to manage or fund our existing operations, which could result in a material and adverse effect on our future results of operations and financial condition.

(ii) Unwillingness on the part of the group of lenders that provide our CS credit agreement to do any of the following:

- Provide a waiver or amendment for any covenant violations we may experience in future periods, thereby triggering a default under, or termination of, the revolving credit line and term loan, or
- Approve any other amendments to the CS credit agreement we may seek to obtain in the future.

Any lack of renewal, waiver, or amendment, if needed, could result in the revolving credit line and CS term loan becoming unavailable to us and any amounts outstanding becoming immediately due and payable. In the case of our borrowings at December 31, 2011, this would mean $68.6 million could become immediately payable.

(iii) Further impairment of our financial flexibility, which could require us to raise additional funding in the capital markets sooner than we otherwise would, and on terms less favorable to us, if available at all.

Any of the above mentioned items, individually or in combination, could have a material and adverse effect on our results of operations, available cash and cash flows, financial condition, access to capital and liquidity.

CRITICAL ACCOUNTING ESTIMATES AND POLICIES

Our discussion and analysis of the financial condition and results of operations is based on the accompanying unaudited Condensed Consolidated Financial Statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these statements requires us to make significant estimates and judgments about future uncertainties that affect reported assets, liabilities, revenues and expenses and related disclosures. We base our estimates on historical experience and on various other assumptions believed to be reasonable under the circumstances. In the event that estimates or assumptions prove to be different from actual results, adjustments are made in subsequent periods to reflect more current information. The accounting estimates requiring our most difficult, subjective or complex judgments because these matters are inherently uncertain are unchanged from March 31, 2011, except for the estimated fair value of assets acquired in a business combination described below. These critical accounting estimates and policies have been disclosed in our Annual Report on Form 10-K for the year ended March 31, 2011 filed with the Securities and Exchange Commission on June 14, 2011.

Fair Value of Assets Acquired in a Business Combination

Application of the various accounting principles related to the fair value measurement of certain assets acquired in a business combination are critical accounting estimates because there are matters that are inherently uncertain when making the estimate, different estimates reasonably could be used and changes in the estimate that are reasonably possible could materially impact the resulting valuation and the financial statements. Judgments are required to determine fair values of amortizable intangible assets, in-process research and development and the resulting amount of goodwill. Significant estimates and assumptions include:

- Planned product roadmaps, including the primary feature sets of new products;
- Expected efforts and associated costs required to integrate technologies acquired into new products;
- Assessed importance of in-process research and development to our overall development plan;
- Estimated values and rates of a market participant;
- Estimated future cash flows of current and future products; and
- Estimated discount rate applied to future cash flows.

In addition, the estimated future life of purchased technology intangibles impacts future financial statements. We believe the assumptions and estimates used and the resulting balances are reasonable; however, actual results may differ from these estimates under different assumptions or conditions.

RECENT ACCOUNTING PRONOUNCEMENTS

In the first quarter of fiscal 2012, we adopted the goodwill impairment guidance for reporting units with zero or negative carrying amounts and adopted the guidance for disclosure of supplementary pro forma information for business combinations. The adoption of these standards did not have an impact on our financial position or results of operations, other than additional disclosures. For information regarding our assessment of other recent accounting pronouncements, refer to Note 2: Significant Accounting Policies; New Accounting Standards.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Changes in interest rates affect interest income earned on our cash equivalents. In addition, changes in interest rates affect interest expense on our borrowings under the CS credit agreement. Our outstanding convertible subordinated notes have a fixed interest rate, thus a hypothetical 100 basis point increase in interest rates would not impact interest expense on these borrowings.

Our cash equivalents consisted solely of money market funds during the nine months ended December 31, 2011. During the first nine months of fiscal 2012, interest rates on these funds were under 1.0% and we earned negligible amounts in interest income.

Interest accrues on our CS term loan at our option, based on either, a prime rate plus a margin of 2.5%, or a LIBOR rate plus a margin of 3.5%. A hypothetical 100 basis point increase in interest rates for the first nine months of fiscal 2012 would increase interest expense $0.7 million.

ITEM 4. CONTROLS AND PROCEDURES

(a) *Evaluation of disclosure controls and procedures*. Our management evaluated, with the participation of our Chief Executive Officer and our Chief Financial Officer, the effectiveness of our disclosure controls and procedures as of the end of the period covered by this Quarterly Report on Form 10-Q. Based on this evaluation, our Chief Executive Officer and our Chief Financial Officer have concluded that our disclosure controls and procedures are effective.

(b) *Changes in internal control over financial reporting.* There was no change in our internal control over financial reporting that occurred during the fiscal quarter covered by this Quarterly Report on Form 10-Q that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

On September 12, 2011, Compression Technology Solutions LLC (CTS) filed a patent infringement lawsuit against a group of companies, consisting of Quantum, CA., Inc., EMC Corporation, Hewlett-Packard Company, International Business Machines Corp., NetApp, Inc. and Quest Software, Inc., in the U.S. District Court in the Eastern District of Missouri, alleging that certain unspecified products of the defendants, characterized as deduplication software systems, and, in the case of Quantum, including Quantum s DXi Series Deduplication software, fall within the scope of patent 5,414,650. CTS is seeking injunctive relief, as well as the recovery of monetary damages, including treble damages for willful infringement. We do not believe we infringe the CTS patent; we believe that the CTS patent is invalid, and we intend to defend ourselves vigorously. Due to the inherent uncertainty of litigation, we cannot identify probable or estimable damages related to the lawsuit.

ITEM 1A. RISK FACTORS

YOU SHOULD CAREFULLY CONSIDER THE RISKS DESCRIBED BELOW, TOGETHER WITH ALL OF THE OTHER INFORMATION INCLUDED IN THIS QUARTERLY REPORT ON FORM 10-Q. THE RISKS AND UNCERTAINTIES DESCRIBED BELOW ARE NOT THE ONLY ONES FACING QUANTUM. ADDITIONAL RISKS AND UNCERTAINTIES NOT PRESENTLY KNOWN TO US OR THAT ARE CURRENTLY DEEMED IMMATERIAL MAY ALSO IMPAIR OUR BUSINESS AND OPERATIONS. THIS QUARTERLY REPORT ON FORM 10-Q CONTAINS FORWARD-LOOKING STATEMENTS THAT INVOLVE RISKS AND UNCERTAINTIES. PLEASE SEE MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS FOR ADDITIONAL DISCUSSION OF THESE FORWARD-LOOKING STATEMENTS.

We rely on indirect sales channels to market and sell our branded products. Therefore, the loss of or deterioration in our relationship with one or more of our resellers or distributors, or our inability to establish new indirect sales channels to drive growth of our branded revenue, especially for disk systems and software solutions, could negatively affect our operating results.

We sell the majority of our branded products to value-added resellers, or VARs, and to direct marketing resellers such as CDW Corporation, who in turn sell our products to end users, and to distributors such as Avnet, Inc., Ingram Micro, Inc. and others. The success of these sales channels is hard to predict, particularly over time, and we have no purchase commitments or long-term orders from them that assure us of any baseline sales through these channels. Several of our resellers carry competing product lines that they may promote over our products. A reseller might not continue to purchase our products or market them effectively, and each reseller determines the type and amount of our products that it will purchase from us and the pricing of the products that it sells to end user customers. Establishing new indirect sales channels is an important part of our strategy to drive growth of our branded revenue.

Specific to our StorNext software sales channel partners, our introduction of StorNext appliance solutions in fiscal 2012 could negatively impact our relationship with channel partners that historically have sold other hardware products in conjunction with our StorNext software, and who we thus compete more directly against.

Certain of our contracts with our distributors contain most favored nation pricing provisions mandating that we offer our products to these customers at the lowest price offered to other similarly situated customers. In addition, sales of our enterprise products, and the revenue associated with the on-site service of those products, are somewhat concentrated in specific customers, including government agencies and government-related companies. Our operating results could be adversely affected by any number of factors including:

- A change in competitive strategy that adversely affects a reseller s willingness or ability to distribute our products;
- The reduction, delay or cancellation of orders or the return of a significant amount of products;
- Our inability to gain traction in developing new indirect sales channels for our branded products;
- The loss of one or more of such distributors or resellers;
- Any financial difficulties of such distributors or resellers that result in their inability to pay amounts owed to us; or
- Changes in requirements or programs that allow our products to be sold by third parties to government customers.

Our operating results depend on a limited number of products and on new product introductions, which may not be successful, in which case our business, financial condition and operating results may be materially and adversely affected.

A limited number of products comprise a significant majority of our sales, and due to increasingly rapid technological change in the industry, our future operating results depend on our ability to develop and successfully introduce new products. To compete effectively, we must continually improve existing products and introduce new ones, such as the DXi-Series, Scalar i6000 and the Scalar i40 and i80 product offerings as well as next generation software such as DXi2.0 and StorNext 4.0. We have also introduced a new product line of StorNext appliances, including the M330, SAEL6000 and SAEL500. We have devoted and expect to continue to devote considerable management and financial resources to these efforts. We cannot provide assurance that:

- We will introduce new products in the timeframe we are forecasting;
- We will not experience technical, quality, performance-related or other difficulties that could prevent or delay the introduction and market acceptance of new products;
- Our new products will achieve market acceptance and significant market share, or that the markets for these products will continue or grow as we have anticipated;
- Our new products will be successfully or timely qualified with our customers by meeting customer performance and quality specifications which must occur before customers will place large product orders; or
- We will achieve high volume production of these new products in a timely manner, if at all.

If we are not successful in timely completion of our new product qualifications and then ramping sales to our key customers, our revenue and results of operations could be adversely impacted. In addition, if the quality of our products is not acceptable to our customers, this could result in customer dissatisfaction, lost revenue and increased warranty and repair costs.

Competition has increased and evolved, and may increasingly intensify, in the data protection market as a result of competitors introducing products based on new technology standards and merger and acquisition activity, which could materially and adversely affect our business, financial condition and results of operations.

Our disk systems compete with product offerings of EMC Corporation (EMC), Hewlett-Packard Company (HP), International Business Machines Corporation (IBM) and NetApp, Inc. (NetApp). A number of our competitors also license technology from competing companies such as FalconStor Software, Inc. and Sepaton, Inc. These competitors are aggressively trying to advance and develop new technologies and products to compete against our technologies and products, and we face the risk that customers could choose competitor products over ours due to these features and technologies. Competition in the disk systems market, including deduplication and replication technologies, is characterized by technological innovation and advancement. As a result of competition and new technology standards, our sales or gross margins for disk systems could decline, which could materially and adversely affect our business, financial condition and results of operations.

Our vmPRO appliances and software for virtual environments primarily compete with offerings from IBM, PhD Virtual Technologies, Quest Software, Inc. and Veeam Software. In addition, there are startup companies and companies expanding into the virtual environment data protection market. These competitors are aggressively trying to advance and develop new technologies and products, and we face the risk that customers could choose competitor products over ours due to these features and technologies. Competition in the data protection market for virtual environments is characterized by technological innovation and advancement. As a result of competition and new technology standards, our sales or gross margins for virtualization software and appliances could decline, which could materially and adversely affect our business, financial condition and results of operations.

Our tape automation products primarily compete with product offerings of BDT Products Inc., Dell, Inc. (Dell), HP, IBM, and Oracle Corporation (Oracle). Increased competition has resulted in decreased prices for tape automation products and product offerings that incorporate new features and technologies. Pricing pressure is more pronounced in the tape automation market for entry-level products and least pronounced for enterprise products. Similar to our competitors, our products may be priced lower and often incorporate new and/or different features and technologies than prior years. We face risks that customers could choose competitor products over ours due to these features and technologies or due to pricing differences. We have managed pricing pressure by reducing production costs and/or adding features to increase value to maintain a certain level of gross margin for our tape automation systems. If competition further intensifies, or if there is additional industry consolidation, our sales and gross margins for tape automation systems could decline, which could materially and adversely affect our business, financial condition and results of operations.

Our devices, which include tape drives and removable hard drives, compete with companies that develop, manufacture, market and sell similar products. The principal competitors for our devices include HP and IBM. Competition and industry consolidation has resulted in decreased prices and increasingly commoditized products. Our response has been to manage our device business at the material margin level and we have chosen not to compete for sales in intense price-based situations or if we would be unable to maintain a certain gross margin level. Our focus has shifted to higher margin opportunities in other product lines. Although revenue from devices has decreased in recent years, our material margins have remained relatively stable over this period. We have exited certain portions of the device market and have anticipated decreased sales of devices. We face risk of reduced shipments of our devices beyond our plans, and could have reduced margins on these products, which could materially and adversely impact our business, financial condition and results of operations.

Additionally, the competitive landscape could change due to merger and acquisition activity in the data protection market, such as consolidations in prior years resulting from the purchase of Sun Microsystems, Inc. by Oracle and the acquisition of Data Domain, Inc. (Data Domain) by EMC. Transactions such as these may impact us in a number of ways. For instance, they could result in:

- Smaller number of competitors having greater resources and becoming more competitive with us;
- Companies that we have not historically competed against entering into one or more of our primary markets and increasing competition in that market(s); and
- Customers that are also competitors becoming more competitive with us and/or reducing their purchase of our products.

These transactions also create uncertainty and disruption in the market, given that it is often unknown whether a pending transaction will be completed, the timing of such a transaction, and its degree of impact. Given these factors and others, such merger and acquisition activity may materially and adversely impact our business, financial condition and results of operations.

Competition has increased and evolved, and may increasingly intensify, in the big data and archive market as a result of competitors introducing products based on new technology standards and merger and acquisition activity, which could materially and adversely affect our business, financial condition and results of operations.

Our StorNext software and StorNext appliances face competition from a number of companies, including Front Porch Digital, EMC and IBM. Competition in the big data and archive market is characterized by technological innovation and advancement, including performance and scale features, and our competitors are aggressively trying to advance and develop new technologies and solutions. We face the risk that customers could choose competitor solutions over ours due to these features and technologies. As a result of competition and new technology standards, our sales from software solutions and appliances could decline, which could materially and adversely affect our business, financial condition and results of operations.

Additionally, the competitive landscape could change due to merger and acquisition activity, such as the acquisition of Isilon Systems, Inc. by EMC. Transactions such as these may impact us in a number of ways. For instance, they could result in:

- Smaller number of competitors having greater resources and becoming more competitive with us;
- Companies that we have not historically competed against entering into one or more of our primary markets and increasing competition in that market(s); and
- Customers that are also competitors becoming more competitive with us and/or reducing their purchase of our products.

These transactions also create uncertainty and disruption in the market, given that it is often unknown whether a pending transaction will be completed, the timing of such a transaction, and its degree of impact. Given these factors and others, such merger and acquisition activity may materially and adversely impact our business, financial condition and results of operations.

Our royalties, branded software and OEM deduplication software revenues are relatively profitable and can significantly impact total company profitability. A significant decline in royalty, branded software or OEM deduplication software revenues could materially and adversely affect our business, financial condition and operating results.

We receive royalty revenue based on tape media cartridges sold by Fujifilm Corporation, Imation Corporation, Hitachi Ltd., Maxell Limited, Sony Corporation and TDK Corporation. Under our license agreements with these companies, each of the licensees determines the pricing and number of units of tape media cartridges that it sells. Our royalty revenue varies depending on the level of sales of the various media cartridge offerings sold by the licensees and other factors, including:

- The size of the installed base of devices and similar products that use tape media cartridges;
- The performance of our strategic licensing partners, which sell tape media cartridges;
- The relative growth in units of newer device products, since the associated media cartridges for newer products typically sell at higher prices than the media cartridges associated with older products;
- The media consumption habits and rates of end users;
- The pattern of device retirements; and
- The level of channel inventories.

Our media royalties depend on royalty rates and the quantity of media consumed in the market. We do not control licensee sales of these tape media cartridges. Reduced royalty rates, or a reduced installed device base using tape media cartridges, would result in further reductions in our royalty revenue and could reduce gross margins. This could materially and adversely affect our business, financial condition and results of operations.

Our branded software revenues are also dependent on many factors, including the success of competitive offerings, our ability to execute on our product roadmap and our effectiveness at marketing and selling our branded software solutions directly or through our channel partners.

Our OEM deduplication software revenues also depend on many factors, including the success of competitive offerings, our ability to execute on our product roadmap with our OEM deduplication software partners, the effort of our OEM deduplication software partners in marketing and selling the resulting products, the market acceptance of the resulting products and changes in the competitive landscape such as that which occurred with EMC s purchase of Data Domain. Our relationship with EMC changed from partner to competitor in deduplication as a result of their acquisition of Data Domain. Following this acquisition, except for the first quarter of fiscal 2011 when significant revenue was recognized in accordance with contractual requirements, our OEM deduplication software revenue has significantly declined, which has negatively impacted our results.

We derive the majority of our revenue from products incorporating tape technology. If competition from new or alternative storage technologies continues or increases, our business, financial condition and operating results could be materially and adversely affected.

We derive the majority of our revenue from products that incorporate some form of tape technology and we expect to continue to derive a majority of our revenue from these products in the next several years. As a result, our future operating results depend in part on continued market acceptance and use of products employing tape technology. Our tape products are increasingly challenged by products using alternative technologies, such as VTL, standard disk arrays and NAS. If disk products gain comparable or superior market acceptance, or their purchase prices decline, the competition resulting from these products would increase as our tape customers migrate toward them.

We are addressing this risk through our own targeted investment in disk systems and other alternative technologies; however, these markets are characterized by rapid innovation, evolving customer demands and strong competition, including competition with several companies who are also significant customers. If we are not successful in our efforts, our business, financial condition and operating results could be materially and adversely affected.

A large percentage of our sales come from a few customers, some of which are also competitors, and these customers generally have no minimum or long-term purchase commitments. The loss of, or a significant reduction in demand from, one or more key customers could materially and adversely affect our business, financial condition and operating results.

Our sales have been and continue to be concentrated among a few customers. For example, sales to our top five customers in fiscal 2011 represented 33% of total revenue. This sales concentration does not include revenues from sales of our media that our licensees sold to these customers, for which we earn royalty revenue. Furthermore, customers are not obligated to purchase any minimum product volume and our relationships with customers are terminable at will. As an example, in fiscal 2011, sales to Dell contributed approximately 10% of our revenue, a decline from prior years. If we experience further declines in revenue from Dell or any of our other large customers, we could be materially and adversely affected. In addition, certain of our large customers are also our competitors, and such customers could decide to reduce or terminate their purchases of our products for competitive reasons.

Many of our tape and disk products are primarily incorporated into larger storage systems or solutions that are marketed and sold to end users by our large OEM customers as well as our value added resellers, channel partners and other distributors. Because of this, we have limited market access to these end users, limiting our ability to reach and influence their purchasing decisions. These market conditions further our reliance on these OEM and other large customers such as distributors and VARs. Thus if they were to significantly reduce, cancel or delay their orders with us, our results of operations could be materially and adversely affected.

If our products fail to meet our or our customers specifications for quality and reliability, our results of operations may be adversely impacted and our competitive position may suffer.

Although we place great emphasis on product quality, we may from time to time experience problems with the performance of our products, which could result in one or more of the following:

- Increased costs related to fulfillment of our warranty obligations;
- The reduction, delay or cancellation of orders or the return of a significant amount of products;
- Focused failure analysis causing distraction of the sales, operations and management teams; or
- The loss of reputation in the market and customer goodwill.

These factors could cause our business, financial condition and results of operations to be materially and adversely affected.

Our capital structure includes debt, which imposes upon us debt service obligations and our Credit Suisse senior credit agreement contains various operating and financial covenants that limit our discretion in the operation of our business. If we are unable to generate sufficient cash flows from operations to meet these debt obligations, our business, financial condition and operating results could be materially and adversely affected.

Our level of indebtedness presents risks to investors, both in terms of the constraints that it places on our ability to operate our business and because of the possibility that we may not generate sufficient cash to pay the principal and interest on our indebtedness as it becomes due.

Potential consequences of having debt include:

- Requiring that we dedicate a significant portion of our cash flow from operations and other capital resources to debt service, thereby reducing our ability to fund working capital, capital expenditures, research and development and other cash requirements;
- Making it more difficult or impossible for us to make payments on other indebtedness or obligations;
- Increasing our vulnerability to adverse economic and industry conditions;
- Limiting our flexibility in planning for, or reacting to, changes and opportunities in the markets in which we compete, such as limiting our ability to engage in mergers and acquisitions activity, which may place us at a competitive disadvantage; and
- Limiting our ability to incur additional debt on acceptable terms, if at all.

Our ability to meet our debt service obligations and fund our working capital, capital expenditures, acquisitions, research and development and other general corporate needs depends upon our ability to generate sufficient cash flow from operations. We cannot provide assurance that we will generate sufficient cash flow from operations to service these debt obligations, or that future borrowings or equity financing will be available to us. Such a failure to repay our debt obligations when due would result in default under our loan agreements. Any such inability to meet our debt obligations could therefore have a material and adverse effect on our business, financial condition and results of operations.

Our Credit Suisse credit agreement (CS credit agreement) contains numerous restrictive covenants that require us to comply with and maintain certain financial tests and ratios, as well as restrict our ability to:

- Incur debt;
- Incur liens;
- Make acquisitions of businesses or entities or sell certain assets;
- Make investments, including loans, guarantees and advances;
- Make capital expenditures beyond a certain threshold;
- Engage in transactions with affiliates;
- Pay dividends or engage in stock repurchases; and
- Enter into certain restrictive agreements.

Our ability to comply with covenants contained in this credit agreement may be affected by events beyond our control, including prevailing economic, financial and industry conditions. In prior years, we violated certain financial covenants under a prior credit agreement and received waivers or amendments for such violations. Even if we are able to comply with all covenants, the restrictions on our ability to operate our business could harm our business by, among other things, limiting our ability to take advantage of financings, mergers, acquisitions and other corporate opportunities.

Our CS credit agreement is collateralized by a pledge of all of our assets. If we were to default and were unable to obtain a waiver for such a default, the lenders would have a right to foreclose on our assets in order to satisfy our obligations under the CS credit agreement. Any such action on the part of the lenders against us could have a materially adverse impact on our business, financial condition and results of operations.

We have taken considerable steps towards reducing our cost structure and may take further cost reduction actions. The steps we have taken and may take in the future may not reduce our cost structure to a level appropriate in relation to our future sales and therefore, these anticipated cost reductions may be insufficient to result in consistent profitability.

In the last several years, we have recorded significant restructuring charges and made cash payments in order to reduce our cost of sales and operating expenses to rationalize our operations following past acquisitions, to respond to adverse economic and industry conditions and from strategic management decisions. We may take future steps to further reduce our operating costs, including future cost reduction steps or restructurings in response to strategic decisions, adverse changes in our business or industry or future acquisitions. We may be unable to reduce our cost of sales and operating expenses at a rate and to a level appropriate in relation to our future sales, which may adversely affect our business, financial condition and operating results.

Our inability to attract and retain skilled employees could adversely impact our business.

We may be subject to increased turnover in our employee base or the inability to fill open headcount requisitions due to competition, concerns about our operational performance or other factors. In addition, we may rely on the performance of employees whose skill sets are not sufficiently developed enough to completely realize the expected fulfillment of their job responsibilities. Either of these situations could impair or delay our ability to realize operational and strategic objectives and cause increased expenses and lost sales opportunities.

Economic or other business factors may lead us to further write down the carrying amount of our goodwill or long-lived assets, such as the $339 million goodwill impairment charge taken in fiscal 2009, which could have a material and adverse effect on our results of operations.

We evaluate our goodwill for impairment annually during the fourth quarter of our fiscal year, or more frequently when indicators of impairment are present. Long-lived assets are reviewed for impairment whenever events or circumstances indicate impairment might exist. We continue to monitor relevant market and economic conditions, including the price of our stock, and perform appropriate impairment reviews when conditions deteriorate such that we believe the value of our goodwill could be further impaired or an impairment exists in our long-lived assets. It is possible that conditions could deteriorate due to economic or other factors that affect our business, resulting in the need to write down the carrying amount of our goodwill or long-lived assets to fair value at the time of such assessment. As a result, our operating results could be materially and adversely affected.

Third party intellectual property infringement claims could result in substantial liability and significant costs, and, as a result, our business, financial condition and operating results may be materially and adversely affected.

From time to time, third parties allege our infringement of and need for a license under their patented or other proprietary technology. While we currently believe the amount of ultimate liability, if any, with respect to any such actions will not materially affect our financial position, results of operations or liquidity, the ultimate outcome of any license discussion or litigation is uncertain. Adverse resolution of any third party infringement claim could subject us to substantial liabilities and require us to refrain from manufacturing and selling certain products. In addition, the costs incurred in intellectual property litigation can be substantial, regardless of the outcome. As a result, our business, financial condition and operating results could be materially and adversely affected.

In addition, certain products or technologies acquired or developed by us may include open source software. Open source software is typically licensed for use at no initial charge. Certain open source software licenses, however, require users of the open source software to license to others any software that is based on, incorporates or interacts with, the open source software under the terms of the open source license. Although we endeavor to comply fully with such requirements, third parties could claim that we are required to license larger portions of our software than we believe we are required to license under open source software licenses. If such claims were successful, they could adversely impact our competitive position and financial results by providing our competitors with access to sensitive information that may help them develop competitive products. In addition, our use of open source software may harm our business and subject us to intellectual property claims, litigation or proceedings in the future because:

- Open source license terms may be ambiguous and may subject us to unanticipated obligations regarding our products, technologies and intellectual property;
- Open source software generally cannot be protected under trade secret law; and
- It may be difficult for us to accurately determine the origin of the open source code and whether the open source software infringes, misappropriates or violates third party intellectual property or other rights.

As a result of our global manufacturing and sales operations, we are subject to a variety of risks that are unique to businesses with international operations of a similar scope, any of which could, individually or in the aggregate have a material adverse effect on our business.

A significant portion of our manufacturing and sales operations and supply chain occurs in countries other than the U.S. We also have sales outside the U.S. We utilize contract manufacturers to produce certain of our products and have suppliers for various components, several of which have operations located in foreign countries including China, Hungary, Japan, Malaysia, Mexico, Singapore and Taiwan. Because of these operations, we are subject to a number of risks including:

- Shortages in component parts and raw materials;
- Import and export and trade regulation changes that could erode our profit margins or restrict our ability to transport our products;
- The burden and cost of complying with foreign and U.S. laws governing corporate conduct outside the U.S.;
- Adverse movement of foreign currencies against the U.S. dollar (the currency in which our results are reported) and global economic conditions generally;
- Inflexible employee contracts and employment laws that may make it difficult to terminate or change the compensation structure for employees in some foreign countries in the event of business downturns;
- Potential restrictions on the transfer of funds between countries;
- Political, military, social and infrastructure risks, especially in emerging or developing economies;
- Import and export duties and value-added taxes; and
- Natural disasters, including earthquakes, flooding, typhoons and tsunamis.

Any or all of these risks could have a material adverse effect on our business.

Our quarterly operating results could fluctuate significantly, and past quarterly operating results should not be used to predict future performance.

Our quarterly operating results have fluctuated significantly in the past and could fluctuate significantly in the future. As a result, our quarterly operating results should not be used to predict future performance. Quarterly operating results could be materially and adversely affected by a number of factors, including, but not limited to:

- Failure to complete shipments in the last month of a quarter during which a substantial portion of our products are typically shipped;
- Customers canceling, reducing, deferring or rescheduling significant orders as a result of excess inventory levels, weak economic conditions or other factors;
- Customer fiscal year-ends and budget availability impacting customer demand for our products;
- Declines in royalty revenues;
- Declines in software revenues;
- Product development and ramp cycles and product performance or quality issues;
- Poor execution of and performance against expected sales and marketing plans and strategies;
- Reduced demand from our OEM or distribution, VAR and other large customers; and
- Increased competition.

If we fail to meet our projected quarterly results, our business, financial condition and results of operations may be materially and adversely affected.

33

If we fail to protect our intellectual property or if others use our proprietary technology without authorization, our competitive position may suffer.

Our future success and ability to compete depends in part on our proprietary technology. We rely on a combination of copyright, patent, trademark, and trade secrets laws and nondisclosure agreements to establish and protect our proprietary technology. As a point of reference, as of March 31, 2011, we held 517 U.S. patents and had 86 U.S. patent applications pending. However, we cannot provide assurance that patents will be issued with respect to pending or future patent applications that we have filed or plan to file or that our patents will be upheld as valid or will prevent the development of competitive products or that any actions we have taken will adequately protect our intellectual property rights. We generally enter into confidentiality agreements with our employees, consultants, customers, potential customers and others as required, in which we strictly limit access to, and distribution of, our software, and further limit the disclosure and use of our proprietary information.

Despite our efforts to protect our proprietary rights, unauthorized parties may attempt to copy or otherwise obtain or use our products or technology. Enforcing our intellectual property rights can sometimes only be accomplished through the use of litigation, such as in the litigation with Riverbed Technology, Inc. settled in fiscal 2009. Our competitors may also independently develop technologies that are substantially equivalent or superior to our technology. In addition, the laws of some foreign countries do not protect our proprietary rights to the same extent as the laws of the U.S.

Because we may order components from suppliers in advance of receipt of customer orders for our products which include these components, we could face a material inventory risk, which could have a material and adverse effect on our results of operations and cash flows.

Although we use third parties to manufacture certain of our products, we also manufacture products in-house. Managing our in-house manufacturing capabilities presents a number of risks that could materially and adversely affect our financial condition. For instance, as part of our component planning, we place orders with or pay certain suppliers for components in advance of receipt of customer orders. We occasionally enter into negotiated orders with vendors early in the manufacturing process of our products to ensure that we have sufficient components for our products to meet anticipated customer demand. Because the design and manufacturing process for these components can be complicated, it is possible that we could experience a design or manufacturing flaw that could delay or even prevent the production of the components for which we previously committed to pay. We also face the risk of ordering too many components, or conversely, not enough components, since supply orders are generally based on forecasts of customer orders rather than actual customer orders. In addition, in some cases, we make non-cancelable order commitments to our suppliers for work-in-progress, supplier s finished goods, custom sub-assemblies, discontinued (end-of-life) components and Quantum-unique raw materials that are necessary to meet our lead times for finished goods. If we cannot change or be released from supply orders, we could incur costs from the purchase of unusable components, either due to a delay in the production of the components or other supplies or as a result of inaccurately predicting supply orders in advance of customer orders. These same risks exist with our third party contract manufacturing partners. Our business and operating results could be materially and adversely affected if we incur increased costs, or are unable to fulfill customer orders.

In addition, several of our disk drive suppliers as well as suppliers of other components for our tape automation products with operations in Thailand were impacted by flooding in October 2011, which has affected those suppliers ability to manufacture a sufficient number of drives and components in order to meet the demands of their customers, including us. Certain suppliers have also announced anticipated price increases for available drives. Continued supply shortages and pricing complexities could materially and adversely affect our supply chain, customer relationships and results of operations. Although we have purchased a supply of hard disk drives to meet estimated demand for the upcoming fiscal quarter, our business and operating results could be materially and adversely affected if we incur increased costs or are unable to meet customer demand.

Some of our manufacturing, component production and service repair are outsourced to third party contract manufacturers, component suppliers and service providers. If we cannot obtain products, parts and services from these third parties in a cost effective and timely manner that meets our customers expectations, this could materially and adversely impact our business, financial condition and results of operations.

Many aspects of our supply chain and operational results are dependent on the performance of third party business partners. We face a number of risks as a result of these relationships, including, among others:

- *Sole source of product supply*
  In many cases, our business partner may be the sole source of supply for the products or parts they manufacture, or the services they provide, for us. Because we are relying on one supplier, we are at greater risk of experiencing shortages, reduced production capacity or other delays in customer deliveries that could result in customer dissatisfaction, lost sales and increased expenses, each of which could materially damage customer relationships and result in lost revenue.

- *Cost and purchase commitments*
  We may not be able to control the costs for the products our business partners manufacture for us or the services they provide to us. They procure inventory to build our products based upon a forecast of customer demand that we provide. We could be responsible for the financial impact on the contract manufacturer, supplier or service provider of any reduction or product mix shift in the forecast relative to materials that they had already purchased under a prior forecast. Such a variance in forecasted demand could require us to pay them for finished goods in excess of current customer demand or for excess or obsolete inventory and generally incur higher costs. As a result, we could experience reduced gross margins and operating losses based on these purchase commitments. With respect to service providers, although we have contracts for most of our third party repair service vendors, the contract period may not be the same as the underlying service contract with our customer. In such cases, we face risks that the third party service provider may increase the cost of providing services over subsequent periods contracted with our customer.

- *Financial condition and stability*
  Our third party business partners may suffer adverse financial or operational results or may be negatively impacted by global and local economic conditions. Therefore, we may face interruptions in the supply of product components or service as a result of financial or other volatility affecting our supply chain. We could suffer production downtime or increased costs to procure alternate products or services as a result of the possible inadequate financial condition of one or more of our business partners.

- *Quality and supplier conduct*
  We have limited control over the quality of products and components produced and services provided by our supply chain business partners. Therefore, the quality of the products, parts or services may not be acceptable to our customers and could result in customer dissatisfaction, lost revenue and increased warranty costs. In addition, we have limited control over the manner in which our business partners conduct their business. Sub-tier suppliers selected by the primary third party could have process control issues or could select components with latent defects that manifest over a longer period of time. Therefore, we may face negative consequences or publicity as a result of a third party s failure to comply with applicable compliance, trade, environmental or employment regulations.

Any or all of these risks could have a material adverse effect on our business. In the past we have successfully transitioned products or component supply from one supplier to another existing supplier of different products or to our own facilities without significant financial or operational impact, but there is no guarantee of our continued ability to do so.

If we do not successfully manage the changes that we have made and may continue to make to our infrastructure and management, our business could be disrupted, and that could adversely impact our results of operations and financial condition.

Managing change is an important focus for us. In recent years, we have implemented several significant initiatives involving our sales and marketing, engineering and operations organizations, aimed at increasing our efficiency and better aligning these groups with our corporate strategy. In addition, we have reduced headcount to streamline and consolidate our supporting functions as appropriate following past acquisitions and in response to market or competitive conditions. Our inability to successfully manage the changes that we implement, and detect and address issues as they arise could disrupt our business and adversely impact our results of operations and financial condition.

We continue to face risks related to the slow economic recovery.

The economic crisis in the U.S. and global financial markets had a material and adverse impact on our business and our financial condition, including reduced demand for our products and concerns about our ability to access capital markets to refinance certain debt. The initial impact of this economic crisis was reflected in our results for the third quarter of fiscal 2009. We continue to face risks related to the slow economic recovery and concerns of a return to a recession, including the impact to our results in the first half of fiscal 2012 from economic conditions in Europe. In addition, concerns about the potential default of various national bonds and debt backed by individual countries as well the politics impacting these, could negatively impact the U.S. and global economies and adversely affect our financial results. Uncertainty about economic conditions poses a risk as businesses may further reduce or postpone spending in response to reduced budgets, tight credit, negative financial news and declines in income or asset values which could adversely affect our business, financial condition and results of operations. In addition, our ability to access capital markets may be restricted which could have an impact on our ability to react to changing economic and business conditions and could also adversely affect our results of operations and financial condition.

Our stock price could become more volatile if certain institutional investors were to increase or decrease the number of shares they own. In addition, there are other factors and events that could affect the trading prices of our common stock.

Five institutional investors owned approximately 37% of our common stock as of March 31, 2011. If any or all of these investors were to decide to purchase significant additional shares or to sell significant amounts or all of the common shares they currently own, that may cause our stock price to be more volatile. For example, there have been instances in the past where a shareholder with a significant equity position began to sell shares, putting downward pressure on our stock price for the duration of their selling activity. In these situations, selling pressure outweighed buying demand and our stock price declined. This situation has occurred due to our stock price falling below institutional investors price thresholds and our volatility increasing beyond investors volatility parameters causing even greater sell pressure. The opposite has also occurred whereby a shareholder purchases a significant equity position, creating demand for our common stock and an increased stock price.

Trading prices of our common stock may fluctuate in response to a number of other events and factors, such as:

- General economic conditions;
- Changes in interest rates;
- Fluctuations in the stock market in general and market prices for technology companies in particular;
- Quarterly variations in our operating results;
- New products, services, innovations and strategic developments by our competitors or us, or business combinations and investments by our competitors or us;
- Changes in financial estimates by us or securities analysts and recommendations by securities analysts;
- Changes in our capital structure, including issuance of additional debt or equity to the public; and
- Strategic acquisitions.

Any of these events and factors may cause our stock price to rise or fall and may adversely affect our business and financing opportunities.

Our design and production processes are subject to safety and environmental regulations which could lead to increased costs, or otherwise adversely affect our business, financial condition and results of operations.

We are subject to a variety of laws and regulations relating to, among other things, the use, storage, discharge and disposal of materials and substances used in our facilities and manufacturing processes as well as the safety of our employees and the public. Directives first introduced in the European Union impose a take back obligation on manufacturers for the financing of the collection, recovery and disposal of electrical and electronic equipment and restrict the use of certain potentially hazardous materials, including lead and some flame retardants, in electronic products and components. Other jurisdictions in the U.S. and internationally have since introduced similar requirements, and we anticipate that future regulations might further restrict allowable materials in our products, require the establishment of additional recycling or take back programs or mandate the measurement and reduction of carbon emissions into the environment. We have implemented procedures and will likely continue to introduce new processes to comply with current and future safety and environmental legislation. However, measures taken now or in the future to comply with such legislation may adversely affect our manufacturing or personnel costs or product sales by requiring us to acquire costly equipment or materials, redesign production processes or to incur other significant expenses in adapting our manufacturing programs or waste disposal and emission management processes. Furthermore, safety or environmental claims or our failure to comply with present or future regulations could result in the assessment of damages or imposition of fines against us, or the suspension of affected operations, which could have an adverse effect on our business, financial condition and results of operations.

We are subject to many laws and regulations, and violation of or changes in those requirements could materially and adversely affect our business.

We are subject to numerous U.S. and international laws regarding corporate conduct, fair competition, preventing corruption and import and export practices, including requirements applicable to U.S. government contractors. While we maintain a rigorous corporate ethics and compliance program, we may be subject to increased regulatory scrutiny, significant monetary fines or penalties, suspension of business opportunities or loss of jurisdictional operating rights as a result of any failure to comply with those requirements. We may also be exposed to potential liability resulting from our business partners violation of these requirements. In addition, U.S. regulatory agencies have recently introduced new enforcement efforts that may proactively seek conduct-related information from companies operating in certain targeted industries or locations, without regard for whether potential violations have been identified. If we were to receive such an information request, we may incur increased personnel and legal costs in order to adequately review and respond to the request. Further our U.S. and international business models are based on currently applicable regulatory requirements and exceptions. Changes in those requirements or exceptions could necessitate changes to our business model. Any of these consequences could materially and adversely impact our business and operating results.

We may be sued by our customers as a result of failures in our products.

We face potential liability for performance problems of our products because our end users employ our storage technologies for the storage and backup of important data and to satisfy regulatory requirements. Although we maintain technology errors and omissions insurance, our insurance may not cover potential claims of this type or may not be adequate to indemnify us for all liability that may be imposed. Any imposition of liability or accrual of litigation costs that is not covered by insurance or is in excess of our insurance coverage could harm our business. In addition, we could potentially face claims for product liability from our customers if our products cause property damage or bodily injury. Although we maintain general liability insurance, our insurance may not cover potential claims of this type or may not be adequate to indemnify us for all liability that may be imposed. Any imposition of liability or accrual of litigation costs that is not covered by insurance or is in excess of our insurance coverage could harm our business.

We must maintain appropriate levels of service parts inventories. If we do not have sufficient service parts inventories, we may experience increased levels of customer dissatisfaction. If we hold excessive service parts inventories, we may incur financial losses.

We maintain levels of service parts inventories to satisfy future warranty obligations and also to earn service revenue by providing enhanced and extended warranty and repair service during and beyond the warranty period. We estimate the required amount of service parts inventories based on historical usage and forecasts of future warranty requirements, including estimates of failure rates and costs to repair, and out of warranty revenue. Given the significant levels of judgment inherently involved in the process, we cannot provide assurance that we will be able to maintain appropriate levels of service parts inventories to satisfy customer needs and to avoid financial losses from excess service parts inventories. If we are unable to maintain appropriate levels of service parts inventories, our business, financial condition and results of operations may be materially and adversely impacted.

Because we rely heavily on distributors and other resellers to market and sell our products, if one or more distributors were to experience a significant deterioration in its financial condition or its relationship with us, this could disrupt the distribution of our products and reduce our revenue, which could materially and adversely affect our business, financial condition and operating results.

In certain product and geographic segments we heavily utilize distributors and value added resellers to perform the functions necessary to market and sell our products. To fulfill this role, the distributor must maintain an acceptable level of financial stability, creditworthiness and the ability to successfully manage business relationships with the customers it serves directly. Under our distributor agreements with these companies, each of the distributors determines the type and amount of our products that it will purchase from us and the pricing of the products that it sells to its customers. If the distributor is unable to perform in an acceptable manner, we may be required to reduce the amount of sales of our product to the distributor or terminate the relationship. We may also incur financial losses for product returns from distributors or for the failure or refusal of distributors to pay obligations owed to us. Either scenario could result in fewer of our products being available to the affected market segments, reduced levels of customer satisfaction and/or increased expenses, which could in turn have a material and adverse impact on our business, results of operations and financial condition.

From time to time we have made acquisitions. The failure to successfully integrate future acquisitions could harm our business, financial condition and operating results.

As a part of our business strategy, we have in the past and may make acquisitions in the future, subject to certain debt covenants. We may also make significant investments in complementary companies, products or technologies. If we fail to successfully integrate such acquisitions or significant investments, it could harm our business, financial condition and operating results. Risks that we may face in our efforts to integrate any recent or future acquisitions include, among others:

- Failure to realize anticipated savings and benefits from the acquisition;
- Difficulties in assimilating and retaining employees;
- Potential incompatibility of business cultures;
- Coordinating geographically separate organizations;
- Diversion of management s attention from ongoing business concerns;
- Coordinating infrastructure operations in a rapid and efficient manner;
- The potential inability to maximize our financial and strategic position through the successful incorporation of acquired technology and rights into our products and services;
- Failure of acquired technology or products to provide anticipated revenue or margin contribution;
- Insufficient revenues to offset increased expenses associated with the acquisition;
- Costs and delays in implementing or integrating common systems and procedures;
- Reduction or loss of customer orders due to the potential for market confusion, hesitation and delay;
- Impairment of existing customer, supplier and strategic relationships of either company;
- Insufficient cash flows from operations to fund the working capital and investment requirements;
- Difficulties in entering markets in which we have no or limited direct prior experience and where competitors in such markets have stronger market positions;
- The possibility that we may not receive a favorable return on our investment, the original investment may become impaired, and/or we may incur losses from these investments;
- Dissatisfaction or performance problems with the acquired company;
- The assumption of risks of the acquired company that are difficult to quantify, such as litigation;
- The cost associated with the acquisition, including restructuring actions, which may require cash payments that, if large enough, could materially and adversely affect our liquidity; and
- Assumption of unknown liabilities or other unanticipated adverse events or circumstances.

Acquisitions present many risks, and we may not realize the financial and strategic goals that were contemplated at the time of any transaction. We cannot provide assurance that we will be able to successfully integrate any business, products, technologies or personnel that we may acquire in the future, and our failure to do so could negatively impact our business, financial condition and operating results.

If the future outcomes related to the estimates used in recording tax liabilities to various taxing authorities result in higher tax liabilities than estimated, then we would have to record tax charges, which could be material.

We have provided amounts and recorded liabilities for probable and estimable tax adjustments that may be proposed by various taxing authorities in the U.S. and foreign jurisdictions. If events occur that indicate payments of these amounts will be less than estimated, then reversals of these liabilities would create tax benefits being recognized in the periods when we determine the liabilities have reduced. Conversely, if events occur which indicate that payments of these amounts will be greater than estimated, then tax charges and additional liabilities would be recorded. In particular, various foreign jurisdictions could challenge the characterization or transfer pricing of certain intercompany transactions. In the event of an unfavorable outcome of such challenge, there exists the possibility of a material tax charge and adverse impact on the results of operations in the period in which the matter is resolved or an unfavorable outcome becomes probable and estimable.

Certain changes in stock ownership could result in a limitation on the amount of net operating loss and tax credit carryovers that can be utilized each year. Should we undergo such a change in stock ownership, it would severely limit the usage of these carryover tax attributes against future income, resulting in additional tax charges, which could be material.

We are exposed to fluctuations in foreign currency exchange rates, and an adverse change in foreign currency exchange rates relative to our position in such currencies could have a materially adverse impact on our business, financial condition and results of operations.

We do not currently use derivative financial instruments for foreign currency hedging or speculative purposes. To minimize foreign currency exposure, we use foreign currency obligations to match and offset net currency exposures associated with certain assets and liabilities denominated in non-functional currencies. We have used in the past, and may use in the future, foreign currency forward contracts to hedge our exposure to foreign currency exchange rates. To the extent that we have assets or liabilities denominated in a foreign currency that are inadequately hedged or not hedged at all, we may be subject to foreign currency losses, which could be significant.

Our international operations can act as a natural hedge when both operating expenses and sales are denominated in local currencies. In these instances, although an unfavorable change in the exchange rate of a foreign currency against the U.S. dollar would result in lower sales when translated to U.S. dollars, operating expenses would also be lower in these circumstances. An increase in the rate at which a foreign currency is exchanged for U.S. dollars would require more of that particular foreign currency to equal a specified amount of U.S. dollars than before such rate increase. In such cases, and if we were to price our products and services in that particular foreign currency, we would receive fewer U.S. dollars than we would have received prior to such rate increase for the foreign currency. Likewise, if we were to price our products and services in U.S. dollars while competitors priced their products in a local currency, an increase in the relative strength of the U.S. dollar would result in our prices being uncompetitive in those markets. Such fluctuations in currency exchange rates could materially and adversely affect our business, financial condition and results of operations.

ITEM 6. EXHIBITS

The Exhibit Index beginning on page 41 of this report sets forth a list of exhibits and is hereby incorporated by reference.

SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

QUANTUM CORPORATION

/s/ LINDA M. BREARD
Linda M. Breard
Chief Financial Officer
(Principal Financial and Chief Accounting Officer)

Date: February 9, 2012

EXHIBIT INDEX

Exhibit Number	Exhibit Description	Incorporated by Reference Form	File No.	Exhibit	Filing Date
3.1	Amended and Restated Certificate of Incorporation of Registrant.	8-K	001-13449	3.1	August 16, 2007
3.2	Amended and Restated By-laws of Registrant, as amended.	8-K	001-13449	3.1	December 5, 2008
3.3	Certification of Amendment to the Bylaws of Quantum Corporation, as adopted on January 20, 2010.	8-K	001-13449	3.1	January 26, 2010
4.1	Stockholder Agreement, dated as of October 28, 2002, by and between Registrant and Private Capital Management.	10-Q	001-13449	4.2	November 13, 2008
4.2	Indenture for 3.50% Convertible Senior Subordinated Notes due 2015, between the Registrant and U.S. Bank National Association, as trustee, dated November 15, 2010, including the form of 3.50% Convertible Senior Subordinated Note due 2015.	8-K	001-13449	4.1	November 15, 2010
31.1	Certification of the Chief Executive Officer pursuant to Section 302(a) of the Sarbanes-Oxley Act of 2002.				
31.2	Certification of the Chief Financial Officer pursuant to Section 302(a) of the Sarbanes-Oxley Act of 2002.				
32.1	Certification of Chief Executive Officer pursuant to 18 U.S.C. section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley act of 2002.				
32.2	Certification of Chief Financial Officer pursuant to 18 U.S.C. section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley act of 2002.				
101.INS	XBRL Instance Document.				
101.SCH	XBRL Taxonomy Extension Schema Document.				
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document.				
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document.				
101.LAB	XBRL Taxonomy Extension Label Linkbase Document.				
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document.				

* Indicates management contract or compensatory plan, contract or arrangement.
Filed herewith.
Furnished herewith.
XBRL (Extensible Business Reporting Language) information is furnished and not filed herewith, is not a part of a registration statement or prospectus for purposes of sections 11 or 12 of the Securities Act of 1933, is deemed not filed for purposes of section 18 of the Securities Exchange Act of 1934, and otherwise is not subject to liability under these sections.